MONEY EXCHANGE & BANKING

PART II

[*Recommended by the Rajputana Board*]

BY

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WITH A

FOREWORD

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FOREWORD

A commercial communication ought to convey a matter politely, clearly and cogently in the briefest space possible. There is no doubt that such a communication calls for skill, and a mastery in it not only makes the writer succeed in his business but also win respect of his correspondents.

The scientific way in which the writer of the present volume has discussed the subject-matter will, I think, arouse a lively interest in the student for this difficult art and help him to acquire a mastery in it.

The book contains much useful information and covers a wide field into which the business activities of the present day have extended themselves. The presentation of the subject-matter has been lucid and interesting, and the author has taken pains to introduce some innovations that are not ordinarily found in books of a similar type.

I hope the book will be found useful by those for whom it is intended.

KALKA PRASAD BHATNAGAR

PREFACE

I have long felt the need of a suitable text-book on commercial correspondence that may give necessary theoretical and practical background for a proper understanding of the specialities of the varied nature of correspondence. There, no doubt, exist some very good books on the subject, but my long teaching experience spreading over a decade and a half has convinced me that our students do not find the presentation of this subject in a way that may arouse necessary and abiding interest for it. For the most part, they, therefore, mug up certain 'Openers,' 'Closers' and sometimes even the 'Context' of specimen letters found in books and evidently the whole thing is done to clear the hurdles of examinations. They have neither interest nor charm : nor do they feel any necessity for devoting the right sort of attention to this most important subject for a commerce degree. As a result of all this, most of the matter so crammed finds bad use full of confusion and misunderstanding.

But the blame does not lie wholly with the students. Firstly because the books available on the subject are written by authors who do not exactly

know the requirements of an *average* Indian student. It is, therefore, no wonder that our students may have some hard time with them and, at best, only try to pick up tit-bits without ever caring for any kind of systematic study. Secondly the scanty attention as heretofore given by our Boards of Studies of Educational Bodies to include this subject only for a few marks either under 'Business Methods' or 'Commerce' or even 'English' is also, to an appreciable extent, responsible for the apparent indifference shown by the students to the study of this subject. Again, the mere mention of 'Commercial Correspondence' under Courses of Studies with no precise limits for different examinations—*junior* and *senior*—makes the task of the students and teachers absolutely vague and uncertain. Evidently they remain in dark as to what is exactly required of them by the examining bodies.

It is, therefore, in the recognition of the aforesaid difficulties that I have made this attempt. I do not, however, lay claim to any originality except, of course, in the manner of arrangement of the whole subject-matter on a plan which, being my own, is substantially different from others. I have made a few departures from the accepted lines of treatment and these I found necessary for a clear exposition of the subject. The whole subject-matter has been

FOREWORD

The importance of Banking as a subject for study to students of Economics and Commerce and businessmen can hardly be emphasised. It is, however, encouraging to find, that the subject has been attracting considerable attention in recent years. This is due, among other reasons, to a recognition of the fact that a proper organisation of Banking and Money Market is a *sine qua non* for the industrial and commercial development of India.

There is no dearth of good books on the subject but most of them deal with a few aspects of the Problem of Banking. The average student has neither the inclination nor the means to buy a number of books. What he needs is a book, which offers in a short compass, a comprehensive and up-to-date presentation of the subject.

Prof. C. P. Srivastava M. A., B. Com., of D. A-V. College, Cawnpore, has just brought out the Second Part of his book "Money, Exchange and Banking" which I have every reasons to

believe, will go a long way to remove this long felt want of the student.

I welcome this latest addition to the literature on the subject as a valuable contribution to the study of Banking. The book covers a wide range of subjects *viz.* The Theory and Practice of Banking, Indian Banking, and the Banking Problems of this country, and is written in an attractive style and in a language which is both precise and intelligible.

The book will admirably meet the requirements of students of Currency and Banking.

B. N. CHATTERJI
M. A., B. L.,

Lucknow
2nd October 1940.

Head of the Dept. of Economics,
Faculty of Commerce,
Lucknow University.

PREFACE TO THE FIRST EDITION

The encouraging response given to the First Part of my book on "Money, Exchange and Banking," by the students of both the Degree and Intermediate classes in Commerce in so short a time has been a source of inspiration and satisfaction to me. It shows that the book has met a real want of the Students of Commerce and Economics.

I am now placing in their hands the Second Part of the Book dealing with the Theory, Practice and Law of Banking in India and with the various constituents of the Indian Money Market and the functions of Central Banks. I have tried to give, in a concise but comprehensive and easily intelligible form, a lot of information, which can be obtained only by perusing a number of the latest standard works on the subject. The Practice and Law of Banking is a very intricate and difficult subject and an average student is deterred by its technicalities. I have tried to present the subject matter in a very simple and easy style, and have throughout kept in view the difficulties of the average student. I have also discussed at length the problems of Indian Banking, indicated the lines of reform in its organisation and emphasised the needs of a suitable and comprehensive Banking Legislation for the

country. It is the only book of its kind which covers the complete course in one small volume. It is sufficient for the Second Paper on Economics for the B. A. and for the B. Com. Currency and Banking Papers; and it can be very profitably used as a suitable text book on Banking by the students of the Intermediate in Commerce Examinations of the U. P. and the Rajputana Boards.

In preparing this volume, of course, I have consulted a number of standard and most up to-date books on the subject, both Indian and foreign, and I am deeply indebted to their authors. I am indeed very grateful to Professor B. N. Chatterji, M. A., B. L., Head of the Department of Economics, Faculty of Commerce, Lucknow University, for his kindly writing the foreword for the book.

D. A-V. College,
Cawnpore.
4th October 1940.

C. P. SRIVASTAVA,
M. A., B. Com.

PREFACE TO THE SECOND ED T''N

The wide and encouraging response given to the first edition of the book has been a source of great pleasure and satisfaction to me. I have taken the opportunity of thoroughly revising, enlarging and making the book most up-to-date and comprehensive The changes introduced by the present world wide war in the functions and working of the Reserve Bank of India have been incorporated and the statistics relating to various types of banks made as up-to-date as possible. I am very thankful to Mr. J. S. Bhatnagar, B. Com. C. A. I. I. B., Sir Pochkhanwala Prizeman, of the local Imperial Bank branch for his very kindly going through the parts dealing with the practice and law of banking and for his valuable suggestions for improving the book.

D. A-V. College,
Cawnpore.
16th September '42

C. P. SRIVASTAVA.

PREFACE TO THE THIRD EDITION

The present edition is the outcome of the popularity and growing need of the book.

The author has revised the book on proposed Banking Legislation and other topics in order to make it up to-date. A new chapter on 'Present War and Indian Banking' has also been added.

We hope both the teachers and taught will find this edition more useful than the previous ones.

1st June 1945. Publishers.

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CHAPTER I

BANKS: THEIR CLASSIFICATION & FUNCTIONS

Banks form a vital part of the financial and credit mechanism of the modern community. They are in fact the nerve-centre of the business and financial world. They are dealers in loanable capital of the community, purchasing it from investors and depositors and selling it to the borrowers, traders and businessmen. They also deal in credit or "rights to receive money" and control and regulate the distribution and circulation of credits, loans and advances; provide facilities for the transfer of loanable funds from one place to another and from one class of people to another not only within a country but also out of it. However, banks are not only "purveyors of money and credit", they are also manufacturers of these. Through note-issue and deposits withdrawable by cheques they create media of exchange for internal circulation and through the bill market and discounting of bills of exchange they not only create facilities for foreign exchange operations and settlement and cancellation of international debts, but also effect the creation of further deposits and credit. "Banks act as agencies for the collection of savings and investments; they create a part of the medium of exchange (*i. e.* bank note and bank deposit subject to cheque)."[1]

1 *Taussig: Principles of Economics, Chap. 24.*

Bank is thus an institution that deals in money and credit. Usually it deals in public money and not its own. It has got only a small part of its funds in share capital ; the bulk of the funds, it handles, is obtained through deposits and loans from the public. The origin of banking has been traced to hoary antiquity *e. g.*, in India it is said to have been in existence as early as the Vedic times and it is also said to have existed in ancient Greece and Rome ; but in those early times it was more of money-lending than banking in the modern sense. The old so-called bankers were in reality not bankers but money-lenders and usurers who loaned out their surplus wealth to be utilised by others at exorbitant rates of interest. They made profits by lending their own capital and carried out only one side of the modern banking operations—borrowing and lending of money.

Jews were the pioneers of early European banking. Commercial banking was well developed in the Italian republics of Venice, Milan, Genoa etc., and the Lombard merchants of Italy had the credit of developing the modern Bill of Exchange which plays so important a part in modern commerce. Some enterprising Lombard merchants went to England and carried on their business in London, and the famous financial centre in London is still named after them as Lombard Street. Before the Lombard merchants in England, gold-smiths and Jewish merchants used to carry on the business of money-changing and lending in the middle ages. By the middle of the 17th century gold-smiths began to receive ornaments and other valuables for safe

custody for which service they charged a commission. They also lent money to the kings like the *Shreshthis* and Jagat Seths of our own country. They used to sit across a bench where they carried on their business, and it was perhaps this practice, which is responsible for the modern nomenclature of banks. (The word bank is derived from the word "banco" *i. e.*, a 'bench' and refers to the practice of the money changers carrying their business across the benches). Gradually, the gold-smiths began to issue signed receipts for funds kept with them, called "'gold smith's notes' embodying an undertaking to return the money to the bearer on demand." These certificates of deposits were not transferable in the beginning but later on they began to be accepted in payment like bank notes. They heralded in this way the dawn of the modern bank note system The repudiation of debts by Charles and others in England led to the loss of public confidence and interfered with the development of investment and banking habits. Later on when confidence was restored money-lenders, merchants and gold-smiths gradually developed into private banking houses of repute.

The gold-smiths found out in course of time that only a small part of the deposits were withdrawn and therefore they could utilise the surplus funds lying idle with them in giving loans to people and earn something thereby. Only a small amount of gold could be kept to meet current withdrawals. This turned out to be so lucrative a business that some of the enterprising merchants and gold-smiths began to attract deposits by giving small interest as inducements

to the depositors and issued certificates of deposits for them. From these humble beginnings gradually, the deposit banking began on a large scale towards the end of the 16th century in Italy and therefrom it spread through the efforts of the Lombard merchants to other places in Europe. In England modern banking began with the establishment of the Bank of England in 1694, and it was only after 1708, when the issue of notes (till then an essential function of all banks) became a monopoly of the Bank, that deposit banking—acceptance of deposits withdrawable by letter at first and by bearer cheques later on—developed among the other joint stock banks of the country and by 1780 the cheque system had been firmly rooted. In India commercial or joint stock banking began to develop only after 1770. But it was only after the application of the principle of limited liability to joint stock banks in 1858 in England and in 1860 in India that the modern joint stock or commercial banks began to develop on a large scale. The chief business of a commercial bank consists of lending and borrowing of money, but in addition to this, most of the operations of the modern banks consist of dealing in "rights to receive money" which are transferable. These are instruments of credit like bills of exchange, promissory notes, hundies, cheques, share certificates, securities etc. Credit is based on faith and involves the element of time and plays a very important part in the development of trade, industry and commerce.

Classes of Banks :—There are various types

of banks carrying on general and specialised banking business *e. g.*, private bankers and firms; joint-stock banks, exchange banks, industrial banks, agricultural and land-mortgage banks, co-operative banks, saving banks and central banks. In India we have indigenous bankers and shroffs, mutual aid societies like Nidhies of Bengal and the Chetties of Madras, Post-office Savings Banks, Co-operative Banks, Land-Mortgage Banks, Joint Stock Banks, Exchange Banks, Imperial Bank of India and the Reserve Bank of India. Sometimes the joint stock banks are classified not according to their functions but according to their mode of incorporation. There are some banks which are established by a Royal Charter or Special Act of Legislature as the Bank of England, Chartered Bank of India, Australia and China and other Exchange Banks, the Old Presidency Banks, the Imperial Bank and Reserve Bank of India. They are regulated by the provisions of their Charters or Acts and the liability of their share-holders is limited. Then there are the joint stock banks with limited liability incorporated under the Indian Companies Act 1913, which are governed by the provisions of that Act in behalf of banking and by the Indian Companies Amendment Act of 1936 *e. g.*, the Central Bank of India, the Allahabad Bank, the Bank of India, the Punjab National Bank and the Bank of Baroda which are known as the "Big Five" and other Indian joint stock banks.

Borrowing and lending are the two fundamental operations of all kinds of banks but some

of them also perform specialised functions. Commercial Banks specialise in short-term credit and finance traders and businessmen; agricultural banks finance the agricultural operations of the cultivators; Land-mortgage banks specialise in long-term credit especially for redemption of old debts of peasants and for permanent equipments on the farms; industrial banks finance long-term credit needs of manufacturers and industrialists for block capital or permanent equipment of the factories and mines and transportation companies; and Exchange banks finance the export and import trade and international loaning operations. The Central or Reserve Bank is a banker's bank, a government bank, a custodian of national reserves; controls and coordinates the services of all other credit agencies and is *"the lender of last resort"*, and fiscal agent to the government. The savings banks and mutual aid societies encourage the habit of thrift and investment and cater specially for people with smaller incomes, while cooperative banks encourage the habit of thrift, self-help, investment and banking among small traders, producers and cultivators and enable them to get the benefits of finance and cheap rates which they cannot provide for themselves single-handed. The private bankers and firms lend and borrow money, finance the current operations of agriculture and internal trade and provide facilities for the remittance of money etc. A detailed description of the functions of the various types of banks in India will be given in the sequel.

Functions and Services of Modern Banks

The functions of a modern joint stock or commercial bank can be classified into four heads :—

(*a*) Borrowing of money or raising of funds.

(*b*) Lending of money.

(*c*) Agency business.

(*d*) Miscellaneous or general utility services.

(*a*) *Borrowing of money* : A *modern bank raises its funds mostly* (*i*) by *receiving money* for *deposits* either on Fixed, Current, Savings Bank or Home-Safe A/cs. and (*ii*) by *raising loans* from other banks. A bank borrows mostly in the shape of deposits, (*iii*) by *issuing notes* if authorised to do so and (*iv*) by *issue of Share Capital.*

(*b*) *Lending of Money* : (*i*) making *loans and advances* to the customers and the public on interest against marketable securities and collaterals ; or (*ii*) against personal security of the borrower, (*iii*) against joint promissory notes or two-names paper ; (*iv*) granting cash credits and over-drafts to well-known and established customers ; and (*v*) discounting bills of exchange.

A modern bank advances money generally against a marketable security pledged with it, against the personal credit with a second signature to the Promissory Note, and against the personal credit of the borrower's note only. In *India* the

first two types of advances are more common as against the third which prevails more in the western countries. Loans and advances here usually take three forms : *Cash Credits*, *Overdrafts* and *Loans* (secured and unsecured). Some banks here also advance against Land and Buildings etc. ; against documents of title to goods, merchandise and life policies etc. Lending through discounting bills of exchange also, owing to the scarcity of trade bills, an absence of bank acceptances, attractive yield of government or gilt-edged securities and the necessity of maintaining relatively a more liquid position than banks in advanced western countries, does not prevail so much in India as in the western countries with more advanced banking systems. It was expected that with the establishment of the Reserve Bank of India as bankers' bank and with its provision of re-discounting facilities to the scheduled banks, the discounting of bills will become a more attractive investment for banks than Government Securities. Inspite of the Bank being there for nine years, however, there has been no fundamental change in the existing conditions.

The borrowing and lending of money and credit are the *principal functions* of modern banks which they perform largely through deposits and discounts. But in addition to this linking of lenders and borrowers of loanable funds, banks these days, perform many other useful functions and services which are of immense utility to their customers and the general public. These *subsidiary services and functions* can be conveniently grouped

together in two heads: agency services and miscellaneous or general utility servic

(c) *Agency Services*: (*i*) Collection and payment of cheques, bills, promissory notes, coupons, dividends, subscriptions, rents, income tax, insurance premia and other periodical receipts and payments; (*ii*) Purchasing shares, stocks, and bonds etc., on the stock exchanges and selling them on behalf of the customers; (*iii*) Serving as correspondents, representatives or agents of their customers and other institutions at home or abroad; (*iv*) Acting as administrators, trustees, executors and attorneys and (*v*) Receiving valuables, jewels, documents and deeds etc., for safe custody.

(d) *Miscellaneous*: (*i*) Making confidential enquiries about the financial stability, integrity and business-like dealings of the would-be customers of their own customers and furnishing confidential information about the financial stability of their own customers. (*ii*) Issuing Letters of credit, Travellers' cheques and Circular Notes and Bank Drafts, and notes (if authorised to do so by the government). (*iii*) Financing the commerce of the country or dealing in foreign exchanges. (*iv*) Financing loan operations or under-writing loans of Government and semi-government bodies like Municipalities, Port Trusts, Improvement Trusts etc. and of corporations. Other

miscellaneous services are : inculcating the habit of thrift and investment among the people, distributing loanable funds and capital throughout the country and mobilising it into productive channels by drawing out money from idle hoards and making it available for investments and providing remittance facilities and accepting bills of exchange.

Place of banks and banking in national economy :—Banks play a very important part in the national economy of a country. Their main business consists of the pooling together of the savings of the masses into a central reservoir and the directing of that through small streams and rivulets into productive channels of agriculture, trade, commerce and industry. They provide opportunities for profitable and safe investments of funds by those who are able to save. They create a habit of thrift and discourage improvidence and extravagance. They finance the various productive activities. They play an indispensable part in mobilising capital and articles of trade both internal and external. In these days of credit economy they supply deposit currency in the form of cheques and thus help in making the system elastic in addition to economising the use of gold and silver coins. By discounting bills, promissory notes and other instruments of credit they further increase the supply of money in circulation and relieve monetary stringency They buy and sell stocks and shares and bonds on the stock exchanges. In fact the banks in modern times provide the life-blood of commerce and industry.

Banks carry on also agency business on behalf of their customers in collection of their dues and the payment of their liabilities. They supply information about the financial stability of would-be customers of their own customers. Banks also act as trustees, administrators and executors. They issue bank notes, bank post bills, bank drafts, and letters of credit (ordinary and circular) circular notes and travellers' cheques. They finance the stock exchange operations and take an active part in the financing of the public debts. They raise loans on security from central banks and thereby strengthen their resources to finance business and industry. They create the machinery for the liquidation of international debts by developing a bill market and accepting the bills as security for advances. They grant cash credits, loans and advances to their customers on the security of movable property or on personal security and sometimes they allow the accounts to be overdrawn by their respectable customers to help them tide over temporary financial stringency. Through the letters of credit, travellers' cheques and circular notes and their international organisation banks are able to dispense with the necessity of a man carrying large quantity of money if he goes on a world tour. Banks also provide remittance facilities for transmitting money from place to place either within or without the country and take care of the valuables, jewels, documents etc., on a small charge. They occasionally finance the purchase of real property and estates. They enter into contracts of guarantee or suretyship and assist industrial undertakings. Sometimes they obtain

pass-ports for their customers and deal with their incoming letters, carry on correspondence with the Income Tax authorities on behalf of their customers and pay their rents or subscriptions. In short, in these days of industrial-cum-commercial stage of economic development, of division of labour, of large scale production, and of world economy and world interdependence, the modern joint stock banks perform a host of very important and indispensable functions and render yeoman services to their customers and the general public. A sound system of banking and credit is the *sine qua non* of modern economic development. A stoppage of the activities of banks for a couple of days will completely eclipse the economic life of the community to-day.

CHAPTER II

BANKING OPERATIONS

Ways and Means Operations of a Bank

The fundamental banking operations of a modern bank refer to borrowing of money and credit or raising working capital and lending of money and credit or the employment of its funds. Banks act as suppliers of currency and credit and they create these through deposits, and issue of notes (if authorised to do so). They have thus two functions borrowing and lending and monetary

functions. Deposit, discount and issue—these three operations comprise virtually the whole of modern credit transactions. So far as the fundamental operation of borrowing or raising working capital is concerned it is usually done through deposits and issue of notes in addition to the share-capital. These deposits, as has been pointed out in the first chapter, may be fixed, current or savings bank deposits. A very small part of the working capital of a joint stock bank is obtained through its share-capital. The overwhelming proportion of it is borrowed from the public or depositors.

Cash Deposits :—Banks borrow from the public in the shape of deposits at smaller rates of interest and lend the funds thus raised at a higher rate and make their profits. There are two kinds of deposits—cash and credit or they are sometimes called direct and indirect deposits. Direct or cash deposits connote the coins, cheques, drafts, bullion and notes etc. deposited by persons or firms in banks who thus get claims upon the banks : or rights to draw upon them orders for the payment of legal tender money. These deposits therefore create demand obligations of banks, to meet which, they must keep cash reserves in adequate quantities guided by their prudence, experience and judgment etc. The depositors are the creditors of the banks and all deposits are therefore liabilities of banks.

"Loans make Deposits." Credit Deposits:—But deposits do not arise only from the receipt of cash etc. form the depositors. They are also created by banks through their lending operations. The larger part of the deposits in the commercial

banks are in the main created by these banks. Loans, overdrafts, cash credits and discounting of bills lead to the creation of credit or indirect deposits. These credit deposits also create similar demand obligations because they are kept in banks and are also withdrawable by cheques And it is these deposits in which banks in U. S. A. and England etc. deal more at present than in the cash deposits. *Banks lend their credit through the issue of their notes and through deposits.* When a customer or a businessman wants to get a loan from a bank he brings to it his promissory note signed by him alone or endorsed and guaranteed by one or two more persons. This note is then discounted by the bank or the bank credits him with a "deposit" of the amount less interest charged for the loan, and the person then has a right to draw cheques upon the bank as if he had actually made a deposit. Usually banking operations these days therefore consist of the purchase of the personal credit of the borrower or a businessman and the sale of the bank's credit to him instead of discounting his note and creating in this way a deposit in his favour. Thus, we find that deposits are first taken by the banks from the public and then part of these deposits are lent out to the customers of the banks; the customers then lend this borrowed money to the banks which in turn create fresh deposits. Hence, *loans are the children of deposits and deposits are the children of loans.* Loans and advances on security and collaterals also produce identical results.

Similarly, if an overdraft is granted by a bank

to a customer, the latter is credited with a deposit of the overdraft and gets a right to withdraw the amount as and when he likes by means of cheques. Exactly the same thing happens when a *bill is discounted* by a bank. The proceeds of the bill—its face value minus interest for the period of the accommodation at an agreed rate are usually not handed over to the person or party accommodated but are kept in the bank to the credit of that party which again entitles him to darw cheques. Similarly when drafts, bills, pro-notes and cheques etc. are paid into a bank for collection, their proceeds are credited as a deposit withdrawable by deposit currency or cheques. Hence, "*Loans make deposits*" : bank loans to businessmen and others create credit deposits.

Creation of additional media of exchange:—The commercial banks create credit largely by their loans which make deposits and these deposits create cheque or deposits currency which are at best "rights to receive money" or credit instruments. It is these cheques which in reality constitute the money of commerce in western countries and to some extent in India. In the words of Mr H. Withers "The money of modern English commerce and finance is the cheque, and the credit dealt in the London money market is the right to draw a cheque." This credit is created through loans and discounts by banks to businessmen creating credit deposits ; and it is also created through cash deposits. Hence, it is called deposit currency.

This creation of credit deposits by banks

leads therefore to an increased supply of media of exchange. In fact in these days of credit economy bank deposits play a more important part in settling transactions and liquidating debts than is done by legal tender money or cash. It will be no exaggeration, therefore, to say that the major portion of the bank's operations consist of buying and selling "rights to receive money" or instruments of credit. Deposit currency plays a more important part in countries with a highly organised money market like England and America but in India it is still in its infancy and, excepting a small minority of the educated classes, the majority of the population is still ignorant of the cheque habit.

When a deposit is made with a bank, it undertakes to honour all cheques drawn by the depositor subject to there being sufficient funds to the credit of the depositor and the cheque being regular and in order. These cheques then circulate by endorsement and delivery and add to the quantity of the media of circulation. They relieve monetary stringency, economise the use of coins and replace provisionally legal tender money. Not only this; when a bank grants an overdraft or cash credit, the same thing follows. That is to say, that amount is still withdrawable by means of cheques only. *The loans, therefore, of a bank create further deposits* withdrawable by cheques, and thus *inflate the quantity of credit instruments or deposit currency in circulation.* If we take into account, the velocities of circulation of these deposits and cheques, then the

quantity of credit created becomes enormous. The deposits increase the powers of the customers for more borrowings and, therefore, it seems as if there is no limit to the amount of deposit currency that banks can create, if they follow a liberal policy of loans and advances and if they are not controlled. This power of creating additional currency has increased immensely the authority and influence of joint stock banks in the business world.

A joint stock bank in turn gets loans and advances form a Central Bank of issue against which it deposits the discounted bills of its customers with Central Bank as a security. *In this way, they open out the possibility of creating a regular bill market.* If the rediscounting facilities by the Central Bank are not available to the commercial banks they will not discount the bills of their customers. This is proved by the absence of a regular bill market in India because there was no central banking institution to provide rediscounting facilities till 1935. This operation with the central bank increases further the powers of commercial banks to make loans and advances to their customers. The ultimate result, therefore, is the same, that is to say, bank deposits multiply and cheques in circulation increase side by side with increased bills of exchange. The commercial banks also carry on the operation of financing internal trade and of dealing in foreign exchanges. In this way genuine trade bills as well as import and export bills on D/A and D/P terms come into

existence and increase further the media of exchange in circulation.

This power of the commercial banks to create credit and deposit currency is limited by the minimum cash reserve which they maintain to honour the demand obligations (although the creation of credit deposits is several times more than the reserve) and by the resources of the Central Banks which through their open market operations and bank rate regulate the supply of credit in accordance with the requirements of trade. There is a close connection between the rate of discount and the amounts held in reserves.

Creation of credit through note-issue:—The second method in which banks lend their credit is through the issue of notes. They increase the media of exchange in this way and help to relieve inelasticity and stringency in the money market. The issue of notes by a bank is fundamentally a creation of credit. A bank note is an instrument of credit, a promissory note* containing an undertaking by the issuing bank to convert it into legal tender money on demand. It is just like an ordinary promissory note payable to bearer and the property in it passes from hand to hand by mere delivery. Each successive holder gets the same right to demand payment of a specified sum from the bank in legal tender money. If the issuing bank is well established and enjoys a goodwill and reputation as regards its stability, its notes

* *Taussig*: "*A bank note is a promise to pay a specified sum to the bearer on demand.*"

are very likely to remain in circulation. A very few of them shall be presented for encashment. Therefore the bank need not keep a large metallic reserve equivalent to the amount of notes issued. Such notes enjoying general acceptability form part of the general media of exchange and perform the functions of money. They replace specie, economise its use, save it from wear and tear and facilitate large payments at very cheap rates. The note-holder is in the same position as the depositor in the bank; he is also a creditor of the bank and the bank has to provide as much for meeting the demands of one as those of the other. Therefore the bank's power to create credit through notes is limited by the reserve it has to keep against the notes issued. "A bank's main business is to lend and to lend not its money or its capital, but its credit. This is what it does when it puts out bank notes. It lends them. It turns over to the borrower instruments which he can use in purchases, and these instruments circulate because the credit of the bank is good. The bank lends him, in other words, *its credit*, which in that form serves as well as money." Thus, a bank issuing notes is creating credit and providing additional purchasing power. For example, if the proportional system of note issue is adopted and the metallic reserve consists of 40% gold coin and bullion, then 60% of the total notes issued are the additional purchasing power; and as these notes are mere promises to pay or "rights to receive money", therefore, their issue amounts to a creation of additional credit. In

recent years, there has been a tendency to deprive commercial banks of their privileges to issue notes and the work has been entrusted to a Central Bank whose powers to create credit through the issue of notes are controlled and regulated with a view to safety, security and convertibility of notes.

So far we have discussed the *borrowing* or ways and means operations of banks *i.e.*, the ways in which they obtain their working capital. Now we shall discuss their *lending* operations; the ways in which banks employ their funds. But before taking up the description of the various ways in which banks employ their funds, let us pause for a moment and look at the nature of banking business, a clear understanding of which is very essential to the grasp of the methods of employing funds.

Nature of banking business:—Banking business consists of receiving of money and credit on deposit and lending it to the public for the financing of the various productive activities of the community. Broadly speaking, there are two kinds of banking which may be called *investment banking* and *commercial banking*. The *nature of* commercial banking consists of short-term lending and borrowing for productive purposes. It is not, strictly speaking a profit-making business. Self-seeking profiteering, and exploitation are alien to the proper banking business. The chief aim of banking is service to the business community and to the public in general. The inculcation of habit of thrift and investment, discouragement of

hoarding, improvidence and extravagance and the setting of moral standards, honesty, and integrity and faith, these are the watch-words of a banker's duty towards the public. As he deals mostly in borrowed money, he has a very heavy moral obligation to utilise it in financing sound business propositions and in lubricating the wheels of industry and trade by pooling together the small savings of the people, collecting them into a central reservoir and mobilising them to meet the requirements of the business community. This is one of the essential features of a bank's business. It is entirely different from mere speculation and jobbery. To buy cheap and sell dear is not its main function. As said above, *service and not profit is the guiding principle of a modern bank.*

Joint-stock banking essentially consists of short-term borrowing and lending. It is quite distinct from investment and financing business. To finance long-term credit with short-term diposits or to sink permanently the funds in long-term investments like lands and buildings, fixtures and fittings, plants and machinery etc.—all these are taboos and forbidden business to a commercial bank. The nature of his liabilities is such that a banker must maintain constantly a fluid or liquid position to be able to meet them.

The third important feature of the nature of a bank's business is that it is *par excellence a* business based on confidence, on credit, honesty, integrity and reliability on the one hand, and sound common sense, judgment and experience

on the other. To be successful, a bank manager must have a profound and sound knowledge of human nature. He must be a man of wider experience, sagacious and prudent, capable of discriminating between the false and the real.

Fourthly, the banker must not hanker after higher profits and interest but after safety and security of his funds. Ordinarily a speculator runs risks ; he cares more for an immediate gain but not so much for security. But a banker must not gamble and risk like a speculator, because his gamble means not only speculation in the fortunes of others, but also their complete ruin, if his judgment is faulty.

CHAPTER III

BANKING OPERANIONS—(*Continued*)

Employment of Funds by Banks

We have seen in the last chapter that a bank raises its working capital partly by issue of share capital but mostly by deposits on Fixed, Current and Savings Bank Accounts.

The second group of banking operations relates to the employment of funds by banks and the ways in which they earn profits. Bankers deal in public money and the rights to receive money, and, as they deal in public or borrowed money and

are entrusted with the surplus funds of the public for safe custody and mobilisation into productive channels, they are the custodians of the national savings of the country, and therefore; they have a moral obligation to utilise them safely and profitably. Success in banking depends upon the care, foresight, experience and judgment displayed by them in the selection of securities for the investment of funds lying idle in their tills. Banking is unlike speculation, and service rather than profit is its motto. Banks must be very chary and cautious in investing the funds of others entrusted to their care so that they do not suffer substantial losses, forfeit the public confidence, and involve many innocent investors into bankruptcies with their fall.

A banker usually finds himself on the horns of a dilemma while employing his funds. On the one hand, he has to care for the safety and security of his funds, and, on the other, for his profits. Money lying in vaults or tills is idle, inert and unremunerative. It is not being profitably employed and bringing an income to the banker. On the other hand, most of the liabilities of the banker are demand liabilities, which involve an undertaking to honour all cheques and drafts drawn by the customers so long as there are sufficient funds to the credit of the customers and there are no irregularities on the cheques. If he fails to honour any genuine drafts or cheques of his customers he invites a run upon him, and inspite of his financial position being sound theoretically, he is compelled to close his doors and declare himself as an

insolvent. Such a contingency leads to a loss of public confidence in the integrity and financial stability of banks in general, engenders a spirit of pessimism, depression and panic-mindedness which puts back the clock of banking development. Therefore, a banker has a greater responsibility on his shoulder than an ordinary borrower or debtor and to be able to meet his obligations he must observe certain fundamental principles which are the rudiments of sound banking.

Points to be considered while employing funds :—First of all to be able to meet his demand liabilities he must keep his assets *liquid i. e.,* his assets must be easily and readily convertible into cash or legal tender money. *Liquidity of assets or their easy and ready realisability into cash is the sine qua non of banking.* He must avoid the locking up of his funds in financing industries or investing in long-term securities or in the purchase of real estates like land and building. In other words, he must draw a clear and judicious distinction between commercial and investmet credit. It has been well said, "*a successful banker is one who can draw a distinction between a bill of exchange and a mortgage.*" If he invests in industries or in land and buildings and other immovable securities, his funds are sunk permanently and they cannot be readily available in times of need to tide over a financial stringency. A prudent banker so marshalls the employment of funds in securities with regard to his demand obligations that they fall due for payment to him in quick succession.

Secondly, he must not on any account finance long-term loans and credits by short term deposits; and thus lock up his funds again.

Thirdly, while employing his funds the banker must care for the safety and the security of his funds. The funds being not his own he should be very cautious and prudent in selecting securities for investment. Self preservation is the first thing every body cares for. However, safety does not mean that the banker should not spend the funds entrusted to his charge. He is not a bailee who has to return an identical thing to the bailor after the expiry of the term of bailment. If he were to do like this his business would come to an end. None-the-less he should take particular care that he does not speculate or invest them unwisely because he would suffer substantial losses thereby and would forfeit the confidence of the public in his soundness and financial stability. Moreover, it is extremely unlikely that all the customers will make a demand for the withdrawal of their funds at the same time except in a grave crisis, and if the banker does not untilise them profitably, it shall be mere hoarding and then the banker may charge heavily for looking after those funds.

Fourthly. he must not identify himself completely with any one industry or particular kind of business. In other words, *he must not lay all his eggs in one basket* but should spread them into as many baskets as can be profitably done. Moreover, he should not advance large amounts of money to

a few persons, however rich and influential they may be. A careful observance of these rudiments of sound banking finance spell success and a failure to do so involves the bank into dire disaster.

Ways of Employment

The various ways in which banks employ their funds can be classified into two broad heads (*a*) *Non-profitable.* (*b*) *Profitable.* The former refers to the dead stock *i. e.*, bank premises and buildings, furniture and fixtures and fittings etc. which the banks must have for their business, but on which they do not earn any profit; and to Cash in Hand and at the Bank or till money which the banks must have with them against the demand obligations on deposits and notes. The latter refer to the methods in which a banker employs his funds for earning profits while keeping in view the fundamental principles of joint-stock banking which we have described above. these are Money at Call or Short Notice or Demand Advances; Discounting Bills of Exchange; Investments in Stock exchange securities; and Loans and Advances to customers on personal security, cash credit and overdrafts or on collaterals.

Cash Reserve

Cash in hand and at the bank comprises notes and coins which are legal tender. As pointed above, most of the liabilities of a banker, arising out of the ways he obtains his funds, are demand obligations. To be able to meet the demand liabilities

on deposits and notes a banker therefore must keep with him sufficient amount of cash reserves or quick assests readily convertible into cash. The money kept in his vaults by the banker for this purpose is called "*till money*". *It appears in the Balance Sheet as Cash in Hand and together with the Cash at the Central Bank forms the first line of defence of the banker.* It is difficult to fix rigidly any percentage of the total liabilities which must be backed by legal tender money in reserve because the amount of the minimum cash reserve depends upon circumstances. It is generally left to the discretion and control of the bank directors and managers Experience has shown that a very small proportion of the deposits made by the customers is withdrawn daily and therefore the banker can employ the remainder in profitable investments. He keeps therefore a very small percentage of cash reserve to meet his demand obligations. This holding is reduced to a minimum to meet demands at the counter and balances at the clearing house and against the contingency of a 'run'.[2]

Factors determining the Cash Reserve

The amount of the reserve cannot be determined by any rule of thumb, but it depends on the care, the foresight, the judgment, and the experience of the banker and on the condition of business and habits of the customers of the place where the office of the bank exists. The Chief factors[3] which

2 Taussig: *Principles of Economics Vol 1, page 342*

3 Tannan: *Law & Practice of Banking, p 279*

determine the minimum cash reserve are, as follows :—

Development of cheque habit :—If payments in the locality are mostly made by deposit currency *i. e.* cheques so that the demand for legal tender money is limited, the amount of cash reserve shall be smaller. On the other hand, if transactions are carried on mostly on cash basis, then a larger reserve would be necessary.

Development of Clearing House System :—If the clearing house system is well developed in the locality so that the mutual indebtedness of the banks there is liquidated by cross payments, a smaller reserve would usually be kept by the banks, because such cross payments economise the use of currency and diminish the effective indebtedness of one bank to another, *e. g.* if a bank has to receive on a particular weekend day one and a half lacs of rupees and were required to pay one lac of rupees, it would be receiving only half a lac of rupees, the remainder one lac being crossed.

Development of investment habit :—Thirdly, if the people of the place are not addicted to hoarding, but invest all their savings in banks, mobility of capital is increased, and therefore the constant inflow and withdrawal of funds into and from the banks, would lead to a smaller cash reserve than would be the case otherwise.

Rediscounting facilities :—Fourthly, if there is well developed bill market providing opportunities

for the investment of his funds by banker into discounting bills of exchange and other instruments of credit which are readily convertible into cash then by judicious planning a banker would so employ his funds according to the currency of the bills as to be able to replenish constantly or regularly his stock-in-trade quickly, and therefore he would require a smaller cash reserve. Further, if there is a Central Bank in the locality to provide rediscounting facilities to the member banks then the amount of cash reserve required would be still smaller because the bankers can depend upon the Central Bank acting as a guide, friend and philosopher to them and granting loans on the security of their discounted bills.

Customs of trade in the locality :—Fifthly, if manufacturing industry is the main business, the turnover will be very quick and therefore, a bank would require a larger amount of cash reserve, whereas if agriculture predominates there, a small cash reserve would suffice.

Nature of Accounts :—Sixthly, if the accounts are of a very fluctuating nature as those of bill brokers, discounting firms etc. then a larger cash reserve would be required because such people would withdraw large amounts of money at a time when the securities are depressed.

Size of deposits :—Seventhly, if the size of deposits is very large and belongs to a smaller number of people, then the cash reserve should be

large enough to meet their heavy withdrawals now and then.

Other Banks' Reserves:—Eighthly, if the other banks of the locality keep a larger cash reserve to win public confidence, then the bank should also have a larger reserve for inspiring public confidence and winning popularity.

Legal requirements:—Ninthly, if the law requires that every bank must maintain a certain percentage of its demand and time liabilities as a reserve with the central bank of the country, then the banks must maintain that ratio as a reserve For example, in Denmark the banks are required to keep a minimum reserve of 10% in cash and commercial papers. The Central Reserve City Banks of America are required to keep 13% of their demand and 3% of their time liabilities, the Reserve City Banks 10% and 3% and the Country Banks 7% and 3% respectively as minimum reserves The Scheduled Banks in India are required to maintain 5% and 2% of their demand and time liabilities as balances with the Reserve Bank of India with a view to safeguard the interests of depositors and control the volume of credit

In India, as we shall see elsewhere, banks do not ordinarily attach much importance to the maintenance of adequate cash reserve and reduce it to dangerous limits for earning higher profits. The Indian Companies Act 1936 has now provided that every banking company, other than a scheduled bank, must keep $1\frac{1}{2}$% of its time, and 5%

of its demand liabilities as the minimum cash reserve. This has been done to ensure stability of the banks and to protect the depositors.

Money at Call and Short Notice

Next in importance, from the point of view of meeting the demand liabilities, to the minimum cash reserve, in order of liquidity, is this item in the Balance Sheet of a bank on the Assets side. It constitutes the second line of defence of the banker and appears usually next to the Cash in hand and at the Bank. It connotes amounts of money lent by the bank to the bill brokers, discounting houses and stock exchange dealers in the money market for a couple of hours or a day or two, and at the most a week or a fortnight, at a small rate of interest. In the London money market the rate is usually $\frac{1}{2}\%$. This amount can be easily called back to strengthen the cash reserve in times of emergency.

In India on account of the paucity of stock exchanges, except in big commercial towns like Bombay and Calcutta, and of bill broking, there is very little of the capital of commercial banks utilised in call loans. They are known here as "demand advances" and in the absence of a well-organised and developed money and bill market they generally take the form of overdrafts and cash credits. These demand loans are so marshalled that some of them are maturing week by week and day by day and their repayment quickly increases the cash resources of the banks. Professor

Taussig says that these "demand loans are usually cold-blooded, made to any one on the deposit of collateral. The debtor must pay without mercy, when called on, and if he fails to do so, the collateral which he has given is sold at once."[2] These loans are safe from the point of view of liquidity in normal times but in periods of panic they are also apt to become frozen. The larger the cash holdings or reserves of the banks the more freely they make advances and therefore there is close connection between interest rates and amounts of money held by banks.

Discounting of Bills

The third line of defence of a bank is "Bills Discounted". Discounting bills is a typical form of short-term loans, and most important form in which a bank lends without any collateral security. The personal security of the acceptor and the drawer is the only security which the bank has in discounting genuine commercial or trade bills, and in case of first class bills this is superimposed with the personal security of the bill broker or a discount house or other commercial banks. A banker employs his funds in discounting bills of exchange by granting accommodation to his customers and charging interest for the accommodation. To discount a bill means to retire it before it is due, or to pay its represent worth, after deducting interest for the unexpired period of the

2 *Principles Vol. I, Page 348.*

bill on its amount at an agreed rate. These commercial bills serve the bank in many ways. They can be rediscounted readily at the central bank, or delivered to the creditors of the bank in lieu of payment, or they can be easily sold in the stock exchange market, and therefore can be converted any time into legal tender money to meet the demand liability. That is to say, a genuine commercial bill is a marketable security, easily rediscountable or disposable. It is very liquid. These bills are a very profitable, stable and secure form of investment inasmuch as they do not allow money to lie idle in the tills, and are easily marketable without an appreciable difficulty or loss, and there is certainty of their payment. The funds in them are employed for a definite and short period, and, according to their tenor, the banker can so arrange their purchases that a sufficiently large number of them fall due for payment to strengthen his cash reserve and meet the demand liabilities, and at the same time enable the banker to earn a profit on his funds.

Discounting bills is a very useful business not only to the banks but it is also very useful to businessmen, traders and manufacturers, as it enables them to replenish their stock of capital very quickly by discounting the bills of their customers and getting their present worth from banks and discount houses. It prevents a locking up of their capital, ensures quick turn-overs, and enables them to get more credit on their strength from their creditors and banks. It helps to a very great extent in making credit system elastic

and thus relieving monetary stringency. It is a very popular form of investment in western countries with the commercial banks. In England and Wales, for example in 1928, 20% of the total working capital of the commercial banks was employed in discounting bills, but in India hardly 2 to 3% of the total working capital of the joint stock banks is employed in this manner. In 1931, it was only 13% in case of the Imperial Bank of India and less than 2% in case of the Big Six commercial banks of the country. In fact, it formed so little a part of the total working capital that this item is not shown separately in the balance sheet and is merged up with the demand loans and advances. Owing to the paucity of trade bills and the absence of bank acceptances, the banks in India do not invest a substantial portion of their resources in discounting bills, but rather they employ their funds in purchasing government securities and treasury bills.

Investments

The fourth line of defence of a banker is investment in stock-exchange securities. They represent investment in government securities, often called gilt-edged securities on account of their absolute safety and security ; bonds, stocks, and loans of semi-government bodies like municipal corporations, port trusts, improvement trusts ; stocks and bonds of railway and other public utility services companies; and shares and stocks of first class commercial companies and industrial corporations.

There are five kinds of stock-exchange securities into which a banker usually invests his resources, and these are:—

(*a*) Government Securities or Public Debts. They refer to treasury bills, loans floated by the Central and Provincial Governments in India and in foreign countries as well as the loans floated by some of the Indian States. They are the safest form of investments and are not subject to violent fluctuations in normal periods. They command a ready sale and also yield a safe and fair profit and dividend. Banks usually prefer to invest their funds in them, not so much for the sake of profits, as for the sake of inspiring public confidence. In India, as pointed out above, banks invest in government securities to maintain a liquid position and to inspire confidence in the depositors to avoid a run. But this renders a large amount of credit immobile, and as pointed by the C. B. Committee, there is a radical defect in the organisation of credit in our country preventing a conversion of stocks into mobile credit ; and the Committee thought that this defect would gradually go away with the establishment of ware houses and of a bill market. Banks usually regard these securities as liquid but in periods of war and panic they cease to be so.

(*b*) Semi-government securities refer to the bonds issued by local authorities like municipal corporations, district boards, improvement trusts, port trusts, etc. as well as loans floated by them. Next to public debts they are the safest form of investment, as usually the assets of these bodies are pledged to the securities to guarantee their repayment of the principal and the interest thereon. They are also easily marketable.

(*c*) Railway securities: The securities of railway corporations refer to the stocks and bonds, debentures, issued by railway companies either state-owned or managed by limited liability companies. Ordinarily the permanent way and buildings, railway rolling stock and materials are hypothecated to secure the advances and loans. If they are owned by the State, then the entire state property is offered as security and there is government guarantee of repayment of principal and interest in other cases. Hence, they are very safe and command a universal market not only within a country but even outside it. They occupy a grade next to the semi-government securities.

(*d*) Public Utility Securities: refer to the bonds, stocks and shares of Electric Supply Corporations, Water and Gas Companies etc. which have a monopoly of supply of certain services in limited

areas and have valuable assets to offer as security. Their bonds and stocks are safe and come after the Railway securities in the grade.

(e) Debentures, Stocks and Shares of joint stock corporations and companies engaged in manufacturing, engineering, mining etc. etc. In order of safety debentures come first, then preference shares, then preferred ordinary and ordinary shares and finally deferred shares. These industrial securities are subject to fluctuations and a banker should not invest his resources specially in financing the permanent equipment of the factories. The securities of the mining corporations are highly speculative and a banker should never invest in them. In case of industrial and trading companies' shares and stocks also the banker must invest very cautiously after considering safety, security, marketability and the yield of such securities.

These stock exchange securities may be short term or long term investments. Short term investments are usually in Treasury Bills of 3, 6, 9, or 12 months, while long term investments refer to loans of Central and Provincial Governments developmental loans and standard securities like 3½% Government Paper in India and Consols in England. Treasury bills are very valuable in times of need because they can be easily realised into cash. As they are issued by the government during slack season, they provide a suitable invest-

ment of the idle funds of the banker, and money can be taken back during the busy season when these bills mature. While selecting stock exchange securities for investment the banker must have in view the following points (*a*) Safety and security of his funds; (*b*) Their easy marketability, (*c*) The stability of their prices; and (*d*) Yield. As a general rule, he should care more for safety than for profit. Ordinarily best security and highest income or profit do not go together. The better the security the lower is the rate of interest.

Loans and Advances

Still another form in which a banker employs his funds is the granting of overdrafts, cash credits, and loans and advances against collaterals. The Indian Companies Act requires the classification of all loans into secured and unsecured and their separate showing in the Balance Sheet. Secured advances are those against which the banker has got a cover in the form of deposit or pledge of marketable securities like stock exchange securities, bullion, goods and documents of title thereof, land and building and deeds of title thereof, and life policies etc. The rates of interest on such loans are usually lower than those on personal security, the banker is safe because he can realise the full amount of the loans from the collateral securities in the event of default or bankruptcy of the customer, or he can repledge them with other banks for getting loans from them. Unsecured loans are those for which the banker has no cover and depends entirely on the personal credit of the borrower.

Such unsecured loans are also called clean advances which ordinarily take two forms :—

(a) advances against the promissory note of the borrower only, usually described as one-name paper ; and,

(b) advances against a two-name paper—that of the borrower and a guarantor or surety. Clean advances on the personal security of the borrower alone are very much prevalent in the western countries but not in India, where two-name paper and collateral securities are insisted upon by the banker. Even loans on two name paper form a very small proportion of the total accommodation allowed by the Indian banks because of the paucity of such papers acceptable to the banks and therefore the greater proportion of loans and advances in India are secured advances against land and building, securities like bonds and shares, and goods etc. kept in the bank's godowns or borrower's godowns under letters of hypothecation. Cash credits are very popular with Indian banks and Indian businessmen: they refer to loans against borrower's promissory notes guaranteed by at least two sureties and often accompanied by pledge of stocks and goods etc. The borrower has the advantage of utilising as much of the loan as he likes and pays interest on that utilised portion only and the banker has the liberty to reduce or withdraw the

accommodation when he likes to do so. Overdrafts are sometimes granted against personal security but very often against collaterals.

CHAPTER IV

COLLATERAL SECURITIES

Usually a banker does not advance money or grants an overdraft to his customer without obtaining a formal deposit of securities from him to guarantee the repayment of the money lent and the interest thereon. Sometimes, however, if the customer is a man of unimpeachable reputation and sound financial position, the banker grants an overdaft or makes an advance on the personal security of the borrower and depends entirely on his integrity, strength of character, prompt and business like dealings for its repayment. But even in such cases to safeguard his position he insists upon the signatures of one or two independent sureties or guarantors on the promissory notes executed for the advance. If there is a surety or guarantor, in the event of default by the principal debtor, the banker has a claim against the surety or a guarantor for the satisfaction of any of his claims if they remain unsatisfied from the property or estate of the debtor. The banker believes rightly perhaps that in number lies safety. Loans on such personal security are called clean advances or unsecured loans.

The security for advances to customers therefore is of two types personal and impersonal or collateral. The personal security usually takes the form of a guarantee or surety-ship, bond or promissory note, and it is given by the customer or by a third party on his behalf. The guarantee may be a continuing guarantee in which case the guarantor is held responsible for the fluctuating balance of account until the whole of the advance is repaid; or it may be a specific guarantee applying to a certain amount or to a certain transaction. The guarantee should be in writing on some note or memorandum. The banker should satisfy himself about the repaying capacity, solvency and reliability of the guarantor before accepting the guarantee and should not rely upon such guarantors whose incomes terminate by death or unemployment. On the default of the principal debtor the banker has the right of general lien on the property of the surety. The doctrine of subrogation applies to a guarantee according to which the guarantor succeeds on payment to all the rights of the banker against the debtor. The contract of guarantee is a *secondary* contract.

Impersonal or collateral security refers to some tangible property pledged as a cover or backing against loans, which can be disposed of by the bank in the event of the failure of the borrowers to repay the loans promptly. Such securities stand by the side of the personal security. Loans against collaterals are, therefore, called secured loans. A collataral security ordinarily takes three forms: (*a*) Lien, (*b*) Pledge and (*c*) Mortgage.

(a) Lien: A banker has a general lien *i. e.* the right of retaining the securities belonging to the customer in his hands until demands against the customer are satisfied provided the securities have come into his hands in the ordinary course of his business as a banker. This right of lien is not created by any special arrangement or agreement, but is implied by the relationship between the banker and his customer. But the right of lien can be terminated by mutual agreement between the parties or by the existence of circumstances which are inconsistent with the right of lien. It is merely a right to retain goods or .securities and does not, as a rule, give any right to sell the relative goods or securities without the consent of the customer. But as a legally recognised custom this implied pledge to retain the securities carries with it the right to realise the securities after due notice to the customer for the satisfaction of claims. It may be particular or general. As to particular lien the securities can be retained only in case of the particular debt against which they were deposited, but in case of general lien, they can be retained for general balance of account.

The lien extends to all negotiable securities like bearer bonds, share warrants, bearer coupons stock and share certificates, bills of exchange, pro-

missory notes and cheques that come into the hands of the collecting banker, as well as to documents of *title to goods* and *deeds of title to land and building.* If the securities have come into his hands in any capacity other than that of a banker, the right of lien cannot be exercised. In other words, in order that the lien may be excercised, the banker must act simply and solely as a banker, the securities must be deposited by or on behalf of a customer who is in debt, and there must be no express or implied contract negativing the lien. It is clear from this that no lien would arise on articles expressly deposited for safe custody, because in that case they have come into the possession of a banker as a bailee and not as a banker. Sometimes, however it becomes difficult to determine a precise line of demarcation between the banker's capacity as a bailee and his essential functions as a banker. No property in goods thus deposited passes to the bailee. He is merely a ware-houseman for the depositor and his liability for loss or theft depends on whether he is a gratuitous bailee or a bailee for hire. As a paid bailee the banker is bound to take expert precautions against loss or damage to the relative goods. A failure to do so will constitute negligence in which case he would incur a personal liability to the customer. The banker as a gratuitous bailee is liable for loss to his customer if it arises from his gross negligence. Similarly a general lien cannot arise in respect of securities deposited for a specific purpose only nor can it be exercised in respect of property of the customer which is pledged as a security for a

particular debt. Further, no lien can arise in respect of property which comes into his hands by mistake. On all bills of exchange, promissory notes and cheques, which come into his possession as a banker, he has a lien.

A banker's general lien ordinarily gives him only a right to retain the securities that come into his hands but in case of fully negotiable securities like bearer bonds, coupons, share warrants to bearers, the lien of the banker implies a pledge conferring upon him the power to sell such securities and satisfy his claims without reference to the customer, if the latter refuses to pay or cannot pay the amount due by him on overdraft or loan account. But this right of sale does not extend to title deeds or documents of title to the goods in which case the banker can only retain the instruments until his demands are satisfied. But even in case of the negotiable securities the lien would not arise if the instruments are placed in the hands of a banker for a special purpose only. Moreover, the banker's lien over negotiable securities like bills, cheques and pro-notes will be defeated if there is some absolute defect like forged endorsement or the banker does not act in good faith Similarly a banker has lien over any money of his customer which comes into his hands in the ordinary course of his business. In any case, however, the banker has no right of lien on the credit balance of a dead customer for any overdraft created by his personal representative nor over the private credit balance or deposit account of a

partner in respect of a debt due to the banker by the firm.

(*b*) Pledge may be defined as an express or implied contract between the creditor and the debtor whereby the debtor hands over actually or constructively goods or documents of title or securities to the creditor and leaves them in the latter's possession as a security for the loan. The ownership of the goods remains vested in the pledgor or the debtor; the pledgee retains the possession of the security till the payment of the loan and can sell it in default. The pledge of non-negotiable securities should be evidenced by a memorandum of deposit or charge giving the details of the contract etc. Hypothecation is similar to pledge but there is no transfer of possession of the hypothecated goods from the debtor to the creditor.

(*c*) *Mortgage* means the pledge of immovable property like land and building as a security for the payment of loans. It may be either *legal* or *equitable*. In a legal mortgage there is the transfer of ownership of the mortgaged property from the mortgagor (debtor) to the mortgagee (the creditor) who gets a right to sell the property upon default by the mortgagor in the payment of interest or the instalments of the principal. On repayment of the loan the mortgagor gets back the full ownership of his property. This

right of the mortgagor to reclaim full ownership is called his *"equity of redemption"*. In an *equitable mortgage*, there is a deposit of either title deeds with or without a memorandum or there is a memorandum of charge without deposit of deed and the mortgagee gets a right of sale only when he obtains a previous sanction or order for foreclosure from the Court.

Principal types of Collateral Securities

The most popular and usual types of securities accepted as covers for advances are stock exchange securities, goods and documents of title thereof, lands and buildings, and life policies. While accepting a collateral security a banker should consider the following points: simplicity of title; ease of transfer; reasonable steadiness of value; readiness of sale; sufficient margin for loss or depreciation; absence of liability; and safety as to title.

Stock Exchange Securities

These form a banking for the greater proportion of loans made by a banker to the money market, the stock exchange brokers and dealers etc. These are divisible into two classes: fully negotiable or convertible and non-negotiable or inconvertible. The former comprise bearer bonds, bearer scrips, shares and stock warrants payable to bearer and debentures or bonds payable to bearer or order. They are transferable by delivery and form an ideal cover for an advance. The

latter class is again subdivided into two classes :— (*a*) Inscribed stocks and (*b*) registered stocks and shares. The inscribed stocks are those the title to which is evidenced by the entry in the books of the bank or other issuer of the stock and transfer thereof can be effected only if the owner attends in person or appoints a duly authorised agent on his behalf. Registered stocks, on the other hand, are evidenced by certificates given duly sealed by the issuing body. The security of the bank in these cases is either a legal transfer or an equitable charge. In case of inscribed stocks, "the stock receipt or acknowledgment issued to the owner of the stock is valueless as a security, since the delivery thereof is not a pre-requisite to transfer of the stock." Therefore, to perfect his title, the banker must get the stock transferred into his name or in the name of his nominee, by inscription in the books of the issuing bank. But in case of bearer certificates with interest coupons attached thereto, or registered stock certificates, it is not necessary to have the formality of inscription for perfecting the title of security.

A legal transfer of registered stocks and shares in a company in the name of the bank or its nominees is effected either in writing or under seal by the execution of a transfer deed; and when it is sent with the certificates to the company, the banker or his nominee is registered as the holder of the shares in the books of the company and a new certificate is issued. A similar procedure is followed in case of the registered shares and bonds of other bodies. The banker

in getting his name registered and accepting shares as security should be very careful to see that the transferor's signature to the transfer deed is not forged and that the shares are not partly paid up, else he will be liable for indemnity in the first case for an indefinite period, and for the payment of calls in the second case.

An equitable charge may be obtained by deposit of certificates only, or by deposit of certificates with a memorandum of deposit or by deposit of the certificates with a memorandum of transfer and duly executed blank transfer. The first of these methods is now very rare, and the first two methods do not give a right to the banker to realise the securities on default of the customer. The banker can, however, call upon the customer to execute a legal transfer and on refusal he can obtain one from a court for a transfer and for power to sell the securities. In blank transfer, the transfer is not complete, and, on default of the customer, the banker can get the shares registered in his own or in his nominee's name. The blanks are useful in case of transfers under hand because they authorise the transferee to complete the blanks when he deems it necessary.

Merits of Stock Exchange securities as a cover for an advance

(1) They can be realized quickly and without difficulty.

(2) Their title being clear and unmistakable they are readily and unexpensively transferable.

(3) Their actual market worth can easily be determined.

(4) They are less liable to violent fluctuations.

(5) They are a trangible and more reliable cover against the advances of a banker.

(6) In times of need, money can be raised on their security from other banks without difficulty.

(7) If they are negotiable securities then the title of the banks to them is quite free from the defects in the title of the offerer provided the banker is a holder for value. 9350

The chief disadvantages of these securities are:—

(1) The banker is called upon to pay the uncalled amount on the shares if they are not fully paid.

(2) The banker's right of lien might be jeopardised by the provisions of the articles of association with regard to forfeiture in default of the payment of the call money.

(3) If the customer fails to maintain the agreed margin the banker may suffer a loss in realising them.

(4) If the securities are not negotiable, then their transfer will not give to the transferee a better title than that of the transferor.

To avoid these dangers, therefore, the banker should take the following precautions:—

(a) He should assure that the market value is properly ascertained,

(b) that if the security offered is a share, it is fully paid or not.

(c) that they do not belong to speculative industrial concerns. A banker should not specially accept as security stocks and shares of petty foreign governments; shares of mining, oil and rubber concerns (because they are highly speculative) and local shares of private companies.

Goods and Documents of Title to Goods

Advantages :

1. They constitute tangible securities.
2. They are not subject to heavy fluctuations in prices.
3. They possess easy marketability.
4. Advances on them are made for short term only.
5. They have an easy valuation.
6. They facilitate commerce and trade in necessaries of life.

Disadvantages :

1. They are liable to deterioration and damage.
2. There are wide fluctuations in their demand due to fashion.
3. There are possibilities of fraud.

The reasons for their unpopularity in India are :—

(a) Lack of adequate means of transport and communication ;

(*b*) Unsatisfactory conditions of law relating to them ;

(*c*) Lack of warehousing and storage facilities.

"General precautions to be taken by a banker"

While accepting goods and documents of title thereof the following precautions should ordinarily be taken by the banker :—

1. The banker should satisfy himself that the customer is trustworthy, honest and prudent and he should have an experience in this line of business.
2. The banker must have familiarity with the technique of different produce markets.
3. Dealings should be confined to owners or duly authorised agents and possession of the securities must be taken.
4. He should see that the goods are necessaries of life which will command a ready market.
5. The goods should be properly evaluated. There should also be periodical revaluation of goods.
6. There should be hedging of unsold stocks.
7. He should satisfy himself that there are proper storage facilities made and there is the insurance of the goods pledged.
8. The banker should have a legal possession of the goods.

9. There should be strict supervision regarding releases.

10. In addition to these precautions the banker should consider also the following points :—

(*a*) To ascertain the contents of the packages he should also ask for the certificates of a reliable packer or depute a responsible representative to supervise the packing at the expense of the borrower.

(*b*) He should take all the copies of the bill of lading to avoid delay in delivery *and to protect himself against fraud.*

(*c*) He should see that there are no oppressive clauses in the bill of lading or charter party.

(*d*) He should get the bill of lading endorsed in blank by the consignee to avoid the liability for the payment of the freight.

(*e*) He should get the insurance policy of the goods and not the broker's note.

(*f*) When he has to part with the B/L. or the goods without the receipt of the amount due from the customer, it is essential that he should get a trust receipt signed by the customer agreeing to hold the goods or their proceeds in trust for the banker so long as the whole amount is not paid off. The banker should be very careful in parting with title deeds of property

even for a short while without the clearance of the advance against them.

The documents dealt with are :—

B/L., R/R., D/W. Warehouse-keeper's Certificate and Delivery Orders which are usually hypothecated against advances.

Lands and buildings as collaterals : Demerits

1. There are many legal or customary hindrances in the transfer of property.
2. Heavy expenses of legal mortgages impair the financial strength of the customer.
3. Inconvertibility into cash is their chief defect.
4. The determination of title is a very difficult and complicated affair.
5. Their valuation is difficult.
6. The fulfilment of a host of formalities before the estate can be disposed off causes delay in realisation of securities.
7. The banker has to undertake repairs and find out tenants.
8. Divergence between the costs of securities and their market values introduces further complications in valuations.
9. A rich variety of land tenures entails the taking of costly expert legal advice and introduces further complications and technicalities.

Life policy as security for an advance: Merits

I It is a security which increases in value as time goes on with the added advantage that the full sum assured with bonuses is payable on the happening of death or attainment of a certain age. But while accepting it the banker must take the following precautions:—

(i) That the premia are properly paid up and that the future premia shall be paid regularly to keep the policy in force.

(ii) That the age of the assured should be *admitted by the company, by* separate letter or by indorsement on the policy because without it a considerable delay will follow in searching for the proof of age.

(iii) In case of a policy in the name of a woman since married a certificate of marriage should also be taken.

(iv) The surrender value of the policy should be ascertained from time to time from the insurance company.

(v) Whether the policy is whole life or endowment: the latter is preferable.

(vi) Whether the policy contains special conditions or restrictions which may reduce its value as a security.

II A life policy as a security avoids the necessity of proving the right of a mortgagor and a mortgagee.

III It can be assigned by a banker to a third party for security of an advance.

IV No question of expensive litigation arises in proving the title as it is in the case of the immovable property or their sale or mortgage.

Disadvantages

I As a contract of assurance is a contract of good faith between the company and the assured and there is a possibility of the company avoiding its liability, if all the material facts have not been disclosed by the assured at the time of the assurance.

II The company may also avoid its liability if the the assured commits suicide or dies by the hands of justice.

III If the policy is taken out by the assured to provide for his wife and children it may not be good for the banker's reputation in the business to claim the proceeds of the policy in the satisfaction of his debt.

IV The value of the policy depends on continuity of the payment of the premia so that a default in the payment of the premia may deprive the banker of his cover unless, he pays premium himself and adds to the debt.

V If the policy has been taken not by the person assured but by a third party, it shall be void as a wager unless the third

party has an insurable interest in the life of the assured.[1]

The banker must bear in mind that assignments of insurance policies take priority in accordance with the dates of their execution and not according to their dates of registration with the insurance companies. Therefore to avoid falling victim to a fraud in advances against life policies the banker should insist upon getting a declaration at the time of the assignment of the policies to it, that the policies had not already been assigned.[2]

CHAPTER V

BANKER AND CUSTOMER

It is fairly difficult to define accurately as to what constitutes a banker because there is no legal definition. The English Bills of Exchange Act 1882 states that "a banker includes any body of persons, whether incorporated or not, who carry on the business of banking" but curiously enough it nowhere defines what is the business of banking. Leading banking authorities, however, like Dr. Hart and Sir John Paget have attempted to give a precise definition of the term banker and their definitions bring out clearly the fundamental feature of the business of banking. According to Dr. H. L. Hart "A banker is one who, in the

1 *For a detailed discussion of these things refer to Tannan's or Davar's Law and Practice of Banking.*

2 *Banking Frauds in India by Sonalker p 28 29*

ordinary course of his business, honours cheques drawn upon him by persons from and for whom he receives money on current account." It is evident from this definition that the banker means a person who receives money on deposit withdrawable by cheques on demand. Mere dealing in money and credit without receipt of deposits withdrawable by cheques will not necessarily entitle a person to be called a banker. The borrowing and lending of money and dealing in credit, for example, are done by money-lenders and bill-brokers but they are not bankers. Sir John Paget makes it still more clear when he says, "It is a fair deduction that no person or body corporate or otherwise can be a banker who does not (*a*) take deposit accounts, (*b*) take current accounts, (*c*) issue and pay cheques and (*d*) collect cheques crossed and uncrossed for his customers."

The Indian Compains Act 1936 gives a still more comprehensive definition of banks and banking business: "A banking company means a company which carries on as its principal business the accepting of deposits of money on current account or otherwise subject to withdrawal by cheque, draft or order" and which carries on in addition a host of other business which Sec. 277 of the Act describes in 17 articles.*

To conclude then, a banker means any person, firm or joint stock company which receives deposits and undertakes to pay them back by means of cheques.

**Refer to Apendix A*

A 'customer', on the other hand, means a person or firm or institution or company having an account in a bank in which sums of money are deposited and out of which money can be drawn without previous notice by means of cheques. It means "a person who has some sort of an account with a banker"—deposit or current account.

The customer may be a person, firm or joint stock company, club, society, association, committee, union or local authority. The contractual relation and the legal rights and obligations arising therefrom necessitate the safe-guarding of his interests by the banker. Before opening an account for a personal customer the banker must undergo certain preliminaries and make necessary enquiries with regard to the status, financial stability, honesty and character and dealings of the customer, his rights, duties and powers etc. and for this he requires a reference or an introduction and makes confidential inquiries either from other banks or references named. Personal interviews with the bank manager are usually preferred to the inquiries from references. Then a specimen signature or signatures of person or persons who are to operate the account would be obtained and kept in the Signature Book for reference or on specially prepared cards kept on the card-indexing principle. These records are maintained in an alphabetical order.

Special Customers : Agents and Joint Accounts :—If a person is to sign as an agent or a

partner or a secretary etc. on cheques and bills, his signature must be obtained in person at the bank office and his rights or authority to sign, draw and indorse cheques and bills must be obtained on the prescribed form of the bank for this purpose. The mandate giving the authority must be clearly and distinctly worded to show whether the person authorised to operate the joint or partnership or company accounts has also the power to overdraw the accounts or not. It is to be remembered in this case that a general authority to transact business and receive and discharge debts does not carry the right to accept or indorse bills ; that an authority to endorse does not necessarily mean an authority to draw ; and the mandate to draw and indorse cheques does not carry with it the mandate to draw, accept or indorse bills of exchange other than cheques, nor does it imply the power to pledge securities for any advance on the account If the agent acts *ultra vires*, the principal cannot be bound. The mandate should also specify the name or names of persons who are to operate the accounts and how the joint accounts are to be dealt with on the death of one or more parties to them.

Minors :—If the customer is a minor (under the age of 18, or 21 years, if under a guardian) the banker must be careful in dealing with him. All agreements with minors are void because they have no capacity to contract and cannot form a rational judgment of its consequences to themselves. Their capacity to incur liability is non-existent ; they are never liable on a bill of exchange as

drawers, acceptors or indorsers. The banker cannot realise the amount of an overdraft, or advance from a minor nor can he realise or retain any securities deposited by the minor as a pledge or collateral for the advance. He can, however, proceed against a guarantor or surety to the minor for the overdraft. According to the Negotiable Instruments Act, a minor may draw, endorse, deliver and negotiate such instrument so as to bind all parties except himself. A minor therefore can repudiate a cheque drawn by him on his attaining majority and a banker cannot proceed against a minor as an indorser when the cheque or bill endorsed by him and accepted by the banker as a discharge is dishonoured. The best course for the banker therefore is to allow a minor to open an account in the name of his guardian or parent, or to open a current account but not to allow the minor to overdraw it. A minor can act as an agent to bind his principal and the banker is safe if he has a written authority empowering the minor to draw, indorse, accept and overdraw. Similarly, a minor can enter into partnership to bind other partners but the banker must have a written authority from other partners allowing the minor to draw and indorse cheques etc.

Married women :—A married woman can open an account and operate it and all money in the account is deemed to belong to her unless the contrary is proved, and, in the absence of an express or constructive notice to the contrary, the banker is discharged, if he pays in good faith the cheques drawn by her. In case of an overdraft

or advance, however, the banker must take special precautions. Her husband is not liable for any act which she performs as an executrix, administratrix or trustee or as an agent in drawing or indorsing cheques.

Insanity or lunacy of a customer, if brought to the notice of the banker, terminates the cheque, and if the banker pays a cheque of an insane customer he does so at his own risk. If the cheque is paid before the notice of insanity is received by the banker then he gets a good discharge. In case of a drunkard or intoxicated person, the transaction should be postponed to another occasion, when the person concerned is in his senses.

Trustees:—In this case the banker should be very careful not to allow the trustee to commit a breach of trust on which he is not liable, until he pays cheques knowingly that there is a breach of trust, or the trust money is not being utilised for the benefit of the persons or for the objects for which the trust has been created. If the trust account is opened in joint names the banker should get a mandate that all of them are to sign cheques, or that the trust deed provides specifically that one or some of the trustees will sign on behalf of all. If it provides for signatures of all the trustees the banker should refuse to honour cheques signed by one or only some of them. A copy of the trust deed should be kept by the banker, and, on the death of a trustee, the account should be stopped, until a new trustee has been appointed and the banker gets his signature. The

bankruptcy of a trustee does not affect his rights to deal with the trust accounts and property, but it is desirable to have a new appointment when a trustee himself becomes a bankrupt, because there is the risk of the trust money being misappropriated or misapplied.

In case of executors and administrators the banker should again take a mandate empowering all or some of them to sign, draw and indorse. Their signatures must be obtained as also a copy of the will or mandate of the High Court.

In case of *partnership and company accounts* a copy of the Partnership deed and mandate of authority to one or all the partners to sign, draw and indorse; and a resolution of the Board of directors of the company athorising the directors to sign, the copies of the Memorandum and Articles of Association, Certificate of Incorporation and Trading certificate, and a copy of the last audited B/S should be taken by the banker. In case of non-trading corporations like railway, water, electricity companies their powers to borrow and pledge should be carefully investigated before opening an account. In case of friendly societies club, trade unions, etc. the resolution of the executive committee empowering the Secretary, Treasurer or President to operate the account and specimen signatures should be obtained. Overdrafts in such cases should he granted after very careful investigations and on security of some person of substantial means.

Relation between Banker and Customer

There are three types of relationship between a banker and his customer :—

(a) Debtor and Creditor.

(b) Agent and principal.

(c) Bailor and Bailee.

The *primary or fundamental relationship* between a banker and his customer is that of a debtor and creditor. The mere opening of a current account with a bank implies a contractual relationship between a customer and his banker in which the banker is ordinarily a debtor to the customer. But sometimes this relationship is reversed. When a banker grants an overdraft or cash credit or advances a loan to his customer, then the customer becomes a debtor and the banker a creditor. This debt through deposit resembles an ordinary debt in that the customer has only the right of an ordinary creditor against the banker if the latter becomes insolvent and he must prove his claim due to him from the bank in the proceedings of bankruptcy. But there is a fundamental difference between an ordinary commercial debt and this debt of the banker; and it is that, in case of an ordinary debt the creditor, unless otherwise agreed, can enforce payment without making a formal request for payment. In other words, it is not necessary that the creditor should make a demand for payment from the debtor and the debtor can pay interest and principal according to stipulations or when he likes, without waiting for a regular

demand to be made by the creditor. But in case of banker's debt to his customer on current or deposit account the debt of the banker arises or becomes "actually and accruing due" only when a demand for payment is made by the customer by drawing a cheque or by giving a notice and surrendering the deposit receipt. Without this demand the debt of the banker to his customer has no legal existence for repayment. Thus, the banker's debt here falls due for payment only when a demand is made for it.

Then, a banker has an absolute right over the money deposited with him; it is *at his free disposal* to be used in any way he likes. It is *lent* to him to be repaid on demand in a current A/c. or after a stipulated notice in a fixed deposit A/c. *The banker is not a bailee and the customer a bailor.* In a contract of bailment the bailee has to return the identical things to the bailor at the expiry of the term of bailment. He enjoys the possession of the thing bailed but its legal ownership remains vested in the bailor. A banker, however, is not expected to return to the customer the identical notes and coins etc deposited; they become the property of the banker who can utilise them as he likes, and he shall return their equivalent in value only as and when the customer demands. If the banker were required to return the identical coins and notes to his customers the business of banking would come to a standstill.

The *second relationship* between the banker

and his customer is that of an agent and a principal. When the banker collects cheques, Bs/E, pronotes and bank drafts, or pays them or accepts bills or remits money on behalf of the customer; or buys and sells stock exchange securities, he is acting as the agent of his principal and his actions bind the customer so long as he acts in good faith and with due diligence and care and within his rights. Besides, a banker may act as an attorney, a trustee, executor or administrator.

The *third relationship* is that of a bailor and bailee. When the banker accepts valuables, jewellery, ornaments and documents etc. for safe custody he is acting as a bailee. The things are handed over to the banker in a locked and sealed box, or in case of deeds or securities in sealed envelopes, and the banker usually is not apprised of their contents. A Safe Custody Receipt is issued by the banker which must be produced before the things can be delivered back by the banker and the customer has to sign on the counterfoil of the receipt at the time of deposit. The banker is only a custodian of the goods thus deposited; the property in them remains vested in the depositor and the banker must return them in identical shape. There is an acute difference of opinion among the leading authorities on banking as to whether the banker in this case is *a gratuitous or a paid bailee* because the banker's liability for theft or loss depends upon this issue. Ordinarily, the banker renders this service to his customer freely or out of courtesy, and, therefore, Sir John Paget regards him as a gratuitous bailee,

whereas, other equally eminent authorities regard the banker as a bailee for reward or for hire, because by keeping the customer's a/c he makes a profit, and if he refuses to receive goods on deposit for safe custody a majority of the customers will transfer their accounts to other bankers. The banker is expected to take due and proper care of the goods prudently and reasonably, and if he fails to take all reasonable and necessary precautions for the safety and preservation of the goods, he is held liable for their loss. If inspite of due diligence, reasonable and necessary care, the goods are lost the banker is not liable to the depositor. i. e. the banker is liable only if he is guilty of negligence not otherwise. If the banker lodges the goods at a place other than his own premises he is liable for loss no matter whether he is guilty of negligence or not. It is a breach of one of the important conditions of the contract.

Special Features of the Relationship

There are a number of special features of the first relationship and the most important of them are as follows :—

(i) The banker must honour all cheques drawn by his customer provided the cheques are in order, there is no irregularity on them, they are presented within reasonable time and there are sufficient funds to the credit of the drawer. This undertaking does not prevent the banker from using the funds deposited as he likes. But the banker must be given reasonable time to collect cheques and bills before the amount can

be withdrawn by the customer. The amounts of cheques sent for collection from other banks can be credited only when they have been collected and upto that time the banker can rightly dishonour cheques by writing "effects not cleared". This liability of the banker to meet the demands of his customer holds goods so long as funds to the credit of the customer in the books of the bank are sufficient, but, when an overdraft is granted, the liability extends to such an overdraft. However, this undertaking does not prevent the banker from dishonouring cheques of the customer if they are not regularly and properly drawn, are forged or mutilated or undated, ante-dated and post-dated, or stale ; or the amounts in words and figures disagree, or material alterations are not initialled by the drawer, or endorsement is forged or is not in order, or when the banker learns of the death, bankruptcy, or insanity of his customer or receives a countermand or a garnishee order etc. In case of wrongful dishonour and the consequent loss of goodwill or money the banker has to pay a reasonable and substantial compensation. The banker is not bound to pay domiciled bills until there is an express agreement.

(ii) *The banker's right to set off and combine accounts:*—If a customer has a number of a/cs with the same bank he can specify

that certain amounts paid to his credit are to be kept in certain accounts and that they are to be applied for meeting cheques or bills. The banker has to agree to it else he should not accept the tender of the amount. If there is no such procedure for appropriation specified by the customer, then the banker has a right to apply funds to reduce or write off any debt (even statute-barred) owed by the customer to him. The appropriation should be intimated to the customer after which it is irrevocable by either party. According to the *Rule in Clayton's* case "where there is a current a/c. between two parties and no evidence of any appropriation by either party of the items therein, the money first paid in shall he deemed to have been first drawn out, *i. e.*, the credits in order of entry in the account shall be deemed to have discharged the debits in the order in which they appear." The rule goes against a banker granting an overdraft against security and therefore to protect himself the banker must *break* the account and inform the customer of the same. If the customer has *More than one account in the same right(e. g. current and deposit A/c. in the same name or 2 a/cs is one name*) the banker can combine the a/cs, on giving a reasonable notice to the customer by setting off any debit against any credit. A trust, or agency, or

partnership, or joint or executorship account cannot be combined with the private account of a customer nor their debits and credits set off against one another.

(*iii*) The banker must observe complete secrecy with regard to the customer's account and must not disclose the true state of the account to the third party "except upon reasonable and proper occasion". This maintenance of absolute secrecy re: the state of customer's account is an implied undertaking of the contract and any breach of duty or negligence in disclosure of the state of accounts which tarnishes the good-will and reputation of the customer will lead to payment of damages by the bank. Even in furnishing a confidential opinion, the banker must act in good faith, and, in the usual and reasonable course of business, supply his considered and truthful opinion about the status and good-will of the customer as regards facts only displayed by the books of account and based on his personal knowledge and should omit details. In the following cases, however, he is not guilty of breach of faith or duty in making a disclosure and a suit for compensation, therefore, will not lie :—

(*a*) when a Court of law requires the bank to submit a true and accurate statement of account ;

(*b*) where such a disclosure is necessitated by public or state interest;

(*c*) when the banker has been named as a reference to his financial status; but in this case the banker must be chary and cautious not to jeopardise the fair name of his customer through inadvertence; and

(*d*) when the interests of the banker require a disclosure *i. e.* (claim for the payment of an overdraft). The banker can be held liable on wrong information to both the customer and to the third party. He should maintain secrecy even after the close of the accounts.

(*iv*) *Banker's Lien as an implied pledge* :—The banker has an implied right to retain as security for general balance due any goods and securities bailed to him. The banker can sell the goods or documents of title etc. and has a general lien over the securities deposited originally for particular lien after the particular claim has been satisfied and the securities remain with him. In case of safe custody deposits, securities, bonds, coupons etc. he has no general lien, nor can he exercise lien on documents or valuables left in his hands by mistake, nor on money or goods deposited for specific purpose. Similarly on customer's private account no lien shall arise on account of firm's debt, nor on

amount not due except in case of bankruptcy. But when no purpose is specified while depositing money or bills or securities general lien attaches to them as also to the surplus proceeds of securities deposited for a specific purpose and to the bonds and coupons which come into his hands for collection. Thus, the lien of the banker is an implied pledge and differs from the general lien in that the banker can sell the goods etc. while others can not. Moreover, banker's lien is not barred by Law of Limitation.

(*v*) So long as the customer's account continues, the banker can *claim incidental charges* and can charge half-yearly *compound interest.*

(*vi*) *Limitation period* :—The Law of Limitation does not apply to current account deposits ; they are not time-barred debts though the customer might not have received any interest or receipt. But in case of fixed deposits, the period is to be counted from the date of return of the deposit receipt, when the return of the same is made a condition precedent to the withdrawal of money. Similarly in case of an overdraft, the period of limitation begins from the time when use is made of the overdraft.

CHAPTER VI

CREDIT AND ITS VARIOUS FORMS

Credit is the foundation of modern commerce and trade ; it is the life-blood of business and industry. The vast superstructure of gigantic business houses and factories, of wholesale and retail trade, and of financial and banking corporations are all based on it. Credit means faith belief or confidence. It is derived from the word 'Credo' which means I believe. It is a belief in the financial strength and ability, solvency, honesty and integrity of the debtor or buyer and his intention to pay which a creditor or seller reposes in him. It is the power of the debtor or buyer to induce the creditor or the seller to allow him the use of the latter's goods or money for a time after the lapse of which he undertakes to redeem his promise to pay. It is thus "an attribute of the borrower." It may be embodied simply in a book entry of the seller or lender or it may take the form of a promissory note or bill of exchange and other instruments of credit. It has been defined by Prof. Gide as "Protracted Exchange" *i.e.* exchange which is complete after the expiry of a certain period of time. Thus, the element of time is an important factor in credit. The introduction of time in any exchange transaction turns it into credit. It is an exchange of present wealth for future. The only difference between sale or cash

sale and credit is that the latter involves a lapse of time between the delivery of the goods and the payment for them.

Usually credit assumes two forms : credit sales and loans of money ; and it has three main elements or factors *viz. belief, time* and *amount*. Without the element of time we can not have any idea of credit ; it can be granted only for a definite and limited period. Then no credit will be granted to any body or firm whose ability and intention to pay after the expiry of the term of credit is doubted by the lender or seller. Hence, belief is another element of credit. Again credit can be granted only to a certain amount dependent on the repaying capacity, honesty and prompt payment and security offered by the borrower. Thus, security personal or tangible may also be said to form an element of credit.

Present goods or wealth are usually preferred to future ones because the future is risky and uncertain, and therefore, to induce the lender or the seller, the buyer or the borrower must undertake to pay higher than the cash or spot price of the goods or principal. The difference between the credit and the cash price is technically called *discount* and that between the amount of the principal and the amount which the borrower pays after the lapse of the period of credit is called *interest*.

Credit is not capital and it does not create wealth ; although some writers think that it does

so. But credit is not an independent factor of production ; it is 'simply permission to use the capital of others'. It does not add to the existing stock of saved and accumulated wealth and capital: but it only transfers it from oneperson to another and determines as to who shall utilise it for further production of wealth or who shall consume it. It does not add directly to the existing national wealth and capital. However; it makes capital more productive by transferring it from those who possess it, but are not able to utilise it to the best advantage, to those who do not possess it but need it and can utilise it to the best advantage in producing wealth in a variety of ways. In other words, it makes possible the utilisation of capital for productive purposes which otherwise would have been spent in unproductive consumption, or been lying in inert hoards. It encourages the growth and accumulation of capital through credit institutions which provide opportunities for investments and promote the habits of thrift and banking. It economises the use of precious metals by supplanting metallic money in circulation and, to the extent that it does the work of money, it increases the quantity of productive capital. It is a cheaper and more convenient and less risky method of remitting money from one place to another specially in large amounts. It lubricates the wheels of commerce and trade, agriculture and industry and by providing large amounts of capital develops them. Financing of agriculture, trade, industry and commerce is facilitated through it. Foreign payments are made more cheaply and

conveniently through instruments of credit. In fact, in these days of credit economy, credit plays a most vital part in the general economic development of a country.

However, credit has also got its *demerits*. Easy and facile credit encourages over-borrowing, improvidence, and extravagance. It encourages a man to live beyond his means and thus get into debts. Credit is a good servant but a bad master. If once a man gets into debt it becomes very difficult for him to get out of it. Bonds of debt shackle him and then his productive efficiency also suffers. Fraud and dishonesty which are the offsprings of extravagance and improvidence demoralise the debtors. In the field of production also credit sometimes leads to very undesirable consequences. Producers borrow very heavily and indulge in speculation and in unsound and rash enterprises and thus play with the money of others which they get through credit and bring disaster not only to themselves but to the innocent investors as well. If there is an over-expansion of credit, there is a boom in business, investments and production and speculations in stock exchange securities become rampant; and these speculative dealings cause financial and banking crises and end in depression to the disadvantage of all. The recent world economic depression was in a very large measure the outcome of such speculative activities on the New York exchanges. But if credit is well guarded, and properly organised, and directed, it is of immense utility to the

businessmen and traders in particular and to the people in general.

Credit therefore to be serviceable must be well organised and planned. This organisation of credit is done by banks and other credit institutions which pool together the savings of the people from idle hoards and direct them into productive channels of trade, industry, commerce and agriculture. They act as middlemen between the investors and the borrowers and by providing facilities for investments stimulate the saving and accumulation of wealth and the growth of capital. They issue and supply various kinds of credit instruments which play so vital a part in modern commerce and banking. Banks create credit through the issue of bank notes and through credit or loan deposits and overdrafts withdrawable by cheques or deposit currency.

Forms of Credit

Broadly speaking there are two kinds of credit : *Bank or Commercial credit* and *non-bank or non commercial credit.* Bank credits include all documents of credit containing an authorisation by a bank to some body to draw bills on the bank which the latter undertakes to honour. They comprise forms of credit which embody an undertaking by the issuing bank to honour drafts drawn under the credit by the grantee or beneficiary (the person or firm in whose favour they are issued) on the fulfilment of certain conditions. However, there is a great ambiguity or looseness

in the use of the term bank credit which frequently refers to investments which do not embody any such undertaking by the issuer. Ordinarily it refers to various forms of Letter of Credit.

Letter of credit is a request made by a banker to his agents and correspondents abroad to cash the drafts of the grantee drawn on the issuing banker on demand and the banker undertakes to honour the drafts on presentation. It is a document which strengthens the credit of the beneficiary or replaces it by the superior credit of the issuing banker. It enables the grantee to obtain funds in a foreign country on the basis of the re-enforced or substituted credit. There are two classes of letters of credit: non-commercial and commercial. The former facilitates tours and trips of travellers and is called Travellers' or General Letter of Credit. Such letters of credit enable travellers to get funds in foreign countries according to their needs for business or pleasure. The issue of these instruments under the authority and signature of the bank granting the credit precludes the necessity of the travellers carrying large amounts of cash with themselves and saves them from the difficulties of getting their money exchanged into the currencies of the other countries The commercial letters of credit facilitate the movement of goods or merchandise and play a very important part in financing international trade. The credit of the buyer or importer is enhanced by the well-known credit of the banker and this enables him to get better terms from the seller. They also enable exporters

to finance their shipment of goods by bank bills instead of trade bills.

Non-Commercial Credits

Travellers' Letters of Credit embody requests addressed by banks to their correspondents and agents abroad requiring them to honour on demand any drafts or cheques drawn by the holders of these instruments on the issuing banks upto a fixed sum. The issuing banks undertake to meet the drafts when presented. They are issued to travellers about to start on a tour or journey. They are issued to the customer for cash down, or to persons well known to the bank, against the payment of the full amount in advance, or against the deposit of a guarantee or other security. *The credits under them are irrevocable, and the letters are neither negotiable nor transferable.* Their chief object, as said above, is to save travellers from the trouble of carrying large sums of money from place to place. Sometimes, the amount of the credit is debited to the current account of the grantee. When the traveller is in the foreign place he gets funds as and when required by producing the letter of credit at one or other of the banks named in a *Letter of Indication* which is issued by the grantor with the letter of credit. Payments are made against a signed receipt or on a bank draft on the issuing bank. The amount paid is then endorsed on the back of the letter and the draft or the receipt is then sent to the issuing bank. The letter of indication has also got a

specimen signature of the grantee so that whenever the payment is made he is required to sign in the presence of the payer to verify the signature and prevent the credit falling into wrong hands. The traveller is instructed to keep this letter separate from the letter of credit so that if the former is lost there is no possibility of fraud. These letters of credit are of three kinds: Circular letters of credit; Limited letters of credit; and Travellers' commercial letters of credit.

Circular Letters of Credit are addressed to agents and correspondents or branches of the issuing bank either at home or abroad and the names of these are mentioned in a Letter of Indication issued to the customer with the letter of credit and bearing his signature. It is signed in the presence of the issuing banker and serves as a means of identification, and for the sake of safety is always carried separately from the letter. It introduces the grantee to the agents and correspondents abroad and relieves the issuing banker of the necessity of advising all his correspondents and agents. *Limited Letters of Credit* are those which are addressed to some of the bank's branches or agents abroad and there is no letter of indication issued; otherwise they are essentially the same as the circular ones. *Travellers' Commercial Letters of Credit* are a special form of limited letter of credit issued to facilitate the purchase of goods at various places by the travellers and cheques or drafts under this arrangement can be cashed only on the presentation of shipping documents relating to the goods.

Similar to the travellers' letters of credit there are travellers' cheques and Circular Notes which fulfil the same purpose. *Travellers' Cheques* are issued in round figures by banks to their customers of repute in exchange for money. The customer has to sign the cheque in the presence of some issuing bank's official after which he can cash it at any agent of the issuing bank or other bank. Sometimes a letter of indication is also attached. The holder is required to sign in the presence of the payer at the time of payment and may be asked to produce his passport for identification.

Circular Cheques are issued by the banks to their agents and correspondents abroad who fill them up and sell to customers about to go to the country of the issuing bank. They are printed in different colours to indicate the maximum amount upto which they can be issued.

Circular Notes: These are similar to circular letters of credit in their purpose but they consist of actual cheques on the issuing banker for certain round sums in the currency of the issuing country. They are delivered to the grantee by the issuing banker in exchange for his cheques or cash for the equivalent amount. On the reverse side of the note is a letter addressed to the agents and correspondents of the issuing bank specifying the name of the holder and referring to the letter of indication in his hands which embodies the request to cash the circular notes and to reimburse themselves by drawing on the issuing banker at sight. A specimen signature of the grantee and number of

the circular notes issued are also mentioned in the letter of indication. The letter must be retained by the holder until all the notes are cashed but should be surrendered to the last banker cashing the note.

Commercial or Bank Credits

Bank Acceptance Credits :—Bank Acceptance credit is absent in India. This is due to the popularity of cash credit, to the absence of documents of titles to goods in suitable form, to the high stamp duty on bills, and to the difficulty of introducing a form of bill acceptable in the whole country on account of diversity of languages.

These are, however, often issued by London bankers and accepting houses and authorise the grantee to draw upon the issuers within prescribed limits, the issuers undertaking to accept and to pay the bills provided they are in proper form and conform to the conditions laid down in the letter of credit. The usual practice for the issue of acceptance credit is that the London importer requests a London banker to issue an acceptance credit in favour of a foreign exporter which enables the foreign exporter easily to negotiate bills drawn on the London banker of established reputation and gives the importer the benefit of that reputation in making his purchases from other countries. By this means the foreign exporter has no fears regarding the due payments of his drafts while the credit of the importer is reenforced by the established reputation of the issuing banker. The London banker or the accepting

house gets a commission for the services from the London importer, who usually gives a guarantee of security to put the banker in funds when, or before, the bills, drawn under the credit, mature for payment. If the importer accommodated enjoys a first class reputation financially the letters of credit may be issued solely on the strength of that reputation and entirely without conditions of attaching the relative documents of title to the goods to the bills. Such a credit is blank or clean or open credit and the bills drawn thereunder are considered and discounted as first class papers.

Exporters in England also arrange acceptance credits with London banks for financing shipments of goods. They draw bills on such banks and not on importers to the extent of 75% of the invoice value of the shipments against the security of the shipping documents. After acceptance by banks these bills are easily discounted.

Blank or Clean Credits are drafts unaccompanied by shipping or other documents and, are extensively used in financing the international trade and international loans, for they are frequently opened by bankers in one country in favour of bankers in another.

Confirmed Credit

A confirmed credit is so called because the issuing banker gives the person in whose favour the credit is to operate a direct undertaking that he would honour, subject to certain terms and conditions, the drafts drawn on him under the

credit. In other words, the banker confirms the promise contained in the letter of credit which is thereby regarded as irrevocable by both the parties and can be safely relied upon by the foreign exporter in whose favour it is issued. The bills drawn under the credit may be accepted either by the issuing bank or by the customer in whose favour it is issued but more usually the former.

An *Unconfirmed credit* differs from the above in that it involves no undertaking on the part of the bank opening the credit to accept bills drawn there-under. Such a credit in fact is nothing more than an intimation to the addressee that at the time of issue the issuing banker is prepared to honour the bills drawn under the credit, provided all conditions as to form, amount and term are complied with. It is, however, possible at any time for the customer opening the credit to cancel it, and if it is done, the issuing banker has no obligation to advise the addressee abroad. Such credits are therefore very unsatisfactory because bills may be drawn there-under before receipt by the addressee of the notice of cancellation in which case the bills would not be honoured on presentation to the issuing banker. The confirmed and non-confirmed credits are also termed as *Revocable* and *Irrevocable* credit in the U. S. A. A revocable credit may be withdrawn by the issuing banker or his customer at any time after its issue ; whereas an irrevocable credit can not be withdrawn once its terms are communicated to the beneficiary. Such credits are used to facilitate the finance of imports and exports.

Revolving or running credits

As opposed to fixed credits, they are so called because the amounts for which they are originally issued are automatically renewed from time to time as the bills drawn under the credit are issued or paid. They are of three main types :—

(a) Where the amount of bills outstanding at any time is limited to a fixed sum but fresh bills may be drawn as the others mature and are paid.

(b) Where the amount drawn from any one draft at any one time is limited to a certain sum which is however automatically renewed when that draft matures and is paid.

(c) Where a single bill upto a fixed amount may be drawn at any one time and the credit automatically renews itself for the same amount after each draft.

Fixed credits are for stipulated amounts available in one or more drafts for a limited period.

Omnibus credits are granted to shippers for drawing round sums on banks against security of general lien over their goods. They enable them to replenish their capital resources and secure prompt payment for their produce.

Marginal Letter of Credit is so called because on the margin of the credit to be used a letter is printed giving details of the terms on which the bill is to be drawn and accepted. It thus forms an

integral part of the bill and must not be detached when it is negotiated. Exporters' credits are also used in the financing of the internal trade but are issued in favour of exporters whose financial position and standing are not so clearly recognisable as those of the banker in whose favour blank credits are issued. They enable the exporters to obtain funds some considerable time before their goods are available for export.

Documentary Credit refers to any one of the various forms of bank credit and the bills under this arrangement are not negotiated or paid unless the documents of title (invoice, bill of lading, marine insurance policy and letter of hypothecation), are attached to them as security. Hence, it means credit which calls for the acceptance of bills against documents of titles to goods.

Cash credit is a credit specially created by a banker in favour of his customer. An advance is allowed under this arrangement on the security of a promissory note signed by the borrower and bearing two more independent signatures. Sometime the note is also secured by hypothecation of goods or stocks. The borrower pays interest only on the amounts of the credit availed of by him and he can also reduce his obligation subject to a minimum interest clause. The bank can also withdraw or reduce the credit when he likes. They are very popular with Indian banks and in Bombay and other places they are usually granted against self-liquidating produce like cotton, jute, rice etc. kept in the godowns of the banks against which

the banks advance upto 75% of the value of the goods pledged.

Book credit :—It is specially in vogue in retail trade and refers to the arrangement in which two firms in trade relation grant mutual credit in each other's books and there is no payment of cash on every transaction. The balances after the set-off of debits and credits are settled by cash payments.

Credit Instruments

The usual forms of credit instruments prevalent in India are the Negotiable Instruments—Cheques, Bills of Exchange and Promissory Notes, Hundies and Bank Drafts.

Cheques :—A cheque is an unconditional order in writing addressed and signed by the customer of a bank requiring the latter to pay on demand a certain sum of money out of his current diposits either to a specified person or his order or to the bearer. It is a bill of exchange drawn on a specified banker and is always payable on demand. It is the simplest and the most popular form of credit instrument. A detailed discussion of cheques and matters concerning them will be found in Chapter VIII. Any person who takes a cheque from another person, accepts it because he has confidence in the financial stability of the drawer and the drawee bank, and believes that on presentation within a reasonable time it shall be converted into legal tender money.

treat a bill bearing a qualified acceptance as dishonoured; and if he takes such a bill without the consent of the previous parties they are absolved from the contingent liability to him. Before the drawee has accepted a bill it is called a *draft*, and afterwards an "acceptance".

A bill must be presented for payment on the due date, during business hours, at the place of residence or trade of the drawee or at any other place mentioned. A failure to do it relieves all previous parties of their liability to the holder. Payment on due date discharges all the parties to the bill; but if payment is refused or acceptance is refused, the bill is said to be dishonoured. A foreign bill requires to be "noted and protested" by a notary public' on dishonour.

A creditor can keep a bill with him till maturity, or can negotiate it to his creditor or can get it discounted. The transfer of the bill like a cheque is done by endorsement* and delivery and the consideration for it is taken for granted. A bill drawn, accepted and negotiated without a consideration but for mutual accommodation of the parties concerned is called an "Accommodation Bill". Such bills are sometimes called 'kites' or "wind mills". The acceptor in this case is merely a surety and not the principal debtor.

A bill of exchange like a Promissory Note not only serves as a written acknowledgment of a debt but puts it in a tangible form and is accepted

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* *See Chapter VIII for endorsement.*

as a proof of indebtedness in courts. It puts the debt in a liquid form and serves as ready cash.

SPECIMEN OF AN INLAND BILL

Rs. 800/-/-

Stamp -/12/-

Cawnpore, 30th July, 1942.

One month after date pay to Messrs. Ram Chandra & Sons or order the sum of Rupees Eight hundred only, for value received.

To
Messrs. Bholanath & Sons,
La Touche Road,
LUCKNOW.

Kedarnath.

SPECIMEN OF A FOREIGN B/E

No. 723 Liverpool, 20th June, 1942.

Stamp

£ 1,000/-/-

Sixty days after sight of this first of Exchange (second and third of the same tenor and date unpaid) pay to the National Bank of India, Ltd, the sum of one thousand pounds only, value received.

To
Messrs. J. J. Bell Dyeing Co. Ltd.
Civil Lines,
CAWNPORE.

For the Chemicals Ltd.,
Silver Smith,
Secretary.

Notes:—There are three kinds of notes: Bank Notes, Currency Notes, and Promissory Notes. A *bank note* is a promissory note made by a bank and payable to bearer on demand; a *currency note* is a promissory note issued by the controller of Currency or the Treasury and is payable to bearer on demand. Both Currency Notes and Bank notes issued by Central Banks form part of the general media of circulation, are universally accepted and are reissued. They bear no interest and stamp unlike private promissory notes which are made on stamped paper.

A *Promissory note* is an unconditional promise in writing made by one person to another signed by the maker, engaging to pay, on demand or at a fixed or determinable future time, a sum certain in money to, or to the order of, a specified person or to bearer. With the only exception that it is an unconditional promise by a debtor to a creditor, all other essentials of a P/N are the same as those of a B/E. There are only two parties to a P/N—the maker and the payee. It requires an *ad valorem* stamp but no acceptance. The maker of the note is the principal debtor. It may be inland or foreign, but unlike a bill it is not drawn in sets and requires no protest on dishonour. All the general rules as to endorsement, negotiation, payment, days of grace and dishonour which apply to a B/E. are applicable to a P/N. A promissory note is incomplete until it is signed by the maker and is delivered to the payee or bearer. It may be single, joint, and joint and several. In case of a joint note all the makers

must be sued together on dishonour, because if any one of them is left out and the full sum is not recovered from the rest, he cannot be used separately to make up the deficiency. In a joint and several note, however, the liability is both joint and several, and therefore, the makers can be sued singly or collectively, and, if the full sum is not recovered from one or more of them, the remainders can be sued. The party which is compelled to pay in a joint or joint and several note can get a

SPECIMEN OF P/N.

Stamp 0-15-0	Cawnpore, 15th June, 1942. Rs. 1000 0-0

Two months after date I promise to pay to Shiam Manohar Lal or order the sum of Rupees one thousand only, for value received.

Rameshwar Swarup.

JOINT P/N.

Stamp 0-15 0	Cawnpore, 10th June 1942. Rs. 1000 0-0

Two months after date we promise to pay to Mr. Sita Ram Singh or order the sum of Rupees one thousand only, for value received.

Ram Chandra Lal,
Mahesh Chandra Singh

prorata contribution from the co-makers of the note. Joint acceptors of a bill are liable only jointly but not severally.

JOINT & SEVERAL P/N.

Stamp 1-8 0	Lucknow, 15th May, 1942. Rs 1500-0-0

Three months after date we jointly and severally promise to pay Mr. Hari Shankar Shrivastava or order the sum of Rupees one thousand and five hundred only, value received.

Shobha Ram,
Harihar Sahai.

N. B.—It a P/N begins as "I promise to pay etc." and is signed by two or more persons, it is a joint and several P/N.

Hundis :—They refer to inland instruments written in local vernacular, which are used by indigenous bankers and shroffs in financing the internal trade of the country. They are not subject to the Negotiable Instruments Act and are generally governed by local customs and usages of trade. But in the absence of such usages or in case of express agreements in writing between the parties, the rules governing Bills of Exchange apply to them. Their form throughout India is old and stereotyped beginning with compliments. They are usually treated like inland bills and may be

payable on demand or after a certain period. If payable on demand they are called *Drashani Hundis,* and if they are usance bills, they are called *Miti* or *Muddati Hundis* and have a currency for 60 or 61 days. There is also a third form which is not *much in vogue* now, known as *Jokhami Hundi.* It was used to finance consignment of goods. A Darshani Hundi may be *Dhanijog* payable to a certain person only; *Shahjog* which like a crossed cheque is payable only to a reputed *Shah;* *Farmanjog* or payable to order ; and *Dekhadnarjog* or payable to bearer.

SPECIMEN OF A DARSHANI HUNDI

Shri Ganeshayanamah

No. 501. *Tarikh* 17th June, 1942.

Sidhi Shri Cawnpore shubh asthanek Shri Pattri Bhai Kanhaiya Lal Ram Chandra jog likhi Etawah se Sita Ram Ram Sahai ka Ram Ram banchna. Apranch Hundi kita nag ek apke upar kari Rupia 500 anken rupia panch sau ke nime rupia dhai sau ke dune pure dena yahan rakkhe Bhai Nihalchand Baldeo Sahai ke miti Jeth Sudi 12 se Hundi pahunche turant rupia sah jog chalan bazar thikana lagay chaukas kar dam dena.

Hundi likhi

Miti Jeth Sudi 12 war Somvar Sambat 1999.

Sita Ram Ram Sahai.

Explanation:—It is a Darshani Hundi drawn on 17th June 1942 or Jeth Sudi 12, 1999, by Messrs. Sita Ram Ram Sahai of Etawah on Messrs. Kanhaiya Lal Ram Chandra of Cawnpore

for Rupees five hundred only in favour of Messrs. Nihalchand Baldeo Sahai and is payable on demand.

MITI OR MUDDATI HUNDI

No. 468	Tarikh 17th June, 1942.
Stamp 4-8-0	Sidhi Shri Lucknow Sudhsthane Shri patri Bhai Shriram Ramnath likhi Cawnpore se Ram Sahai Ram Kishan ki Ram Ram banchana. Apranch Hundi kita nag ek rupia 5000 anken rupia panch hazar jiske nime dhai hazar ka duna pure dena yahan rakhe bhai Imperial Bank of India Ltd. ke miti jeth Sudi 12 se din 61 eksath pichhe name shah jog hundi chalan kaldar chaukas kar dam dena. Hundi likhi miti Jeth Sudi 12, Somvar, Sambat 1999. Ram Sahai Ram Kishan.

Explanation:—It is a miti or usance Hundi drawn on Jeth sudi 12, Sambat 1999 *i. e.* 17th June 1942 for Rupees five thousand only on Messrs. Shriram Ramnath of Lucknow by Ram Sahai Ram Kishan in favour of the Imperial Bank of India Ltd. and payable after 61 days from 17th June or Jeth sudi 12.

Bank Draft may be defined as a cheque drawn by a bank upon its branches or upon other banks either within or without a country. It is always payable on demand to a specified person or to his order and is very convenient for remittance of money to distant towns and countries. For both inland and foreign drafts the bank

charges a commission or fee. A bank draft is issued to a person on his depositing an equal amount of cash with the bank and may be crossed. Payment for drafts is also made by telegrams (T. Ts.). They are not treated as cheques in England.

SPECIMEN OF BANK DRAFT

No. 345 A

Cawnpore June 25, 194

Punjab National Bank, Ltd.

Rs. 500/-

Pay to Banarsidas Ramdas or order Rupees Five hundred only and place the same to the account of the Punjab National Bank Ltd.

To

The Agent,	For the Punjab
Punjab National	National Bank,
Bank Ltd.,	Ltd.,
Delhi.	Dhani Ram Manocha,
	Agent.

Bank-Post Bills:—These are issued by central and other licensed banks freely to public and are payable at 7 or 60 days after sight. They are drawn by the bank on its branches and are very convenient in transferring money within the country.

I O U means 'I owe you'. It is simply a written acknowledgment of debt by one party to another; it is not negotiable, bears no date for repayment, and being neither a receipt nor a promissory note nor an agreement, it requires no stamp.

I O U

Cawnpore, 23rd June, 1942.
Mr. Rama Kant, I O U Ten rupees Uma Kant.
Rs. 10/-/-

Postal Credit Instruments :—There are various forms of Money Orders both inland and foreign and Postal Orders which are used for the remittance of money. But they are not credit instruments in the strict sense of the word; they are not negotiable and they perform one single transaction only. Still they render very useful services to society.

Treasury Bills :—These are mere promissory notes of the Government having a currency from 3 to 12 months. Their security is unquestionable and hence they are universally acceptable. They provide a convenient and cheap method of raising short term loans and are therefore a highly liquid and ideal form of security for a Central Bank to buy and sell. In exchange for deposits at the Central Bank the Government gives a written promise to pay so many months later a round sum.

According to Mr. Sayers, at the end of the 19th century these bills were used only for supply-

ing funds for specific government expenditure and it was only in the present century that they became an unrestricted means of raising funds for the government. During the War they increased in amount and now occupy an important place in short term financing operations of the money market. In England they are issued weekly partly by tender and partly "through the tap" *i.e.* issued to the Government departments(like Savings Banks, Unemployment and other Insurance Funds, Exchange Equalisation A/c. etc.) which have surplus funds to lend. The 'tender' issue is offered to the discount market, banks etc. Each week a batch issued 3 months previously matures and each week a fresh batch is issued to the tune of 30 to 50 millions according to the needs of the Treasury. By arranging the gap between the maturities and the new issue to equal and be in the opposite direction to any discrepancy between current revenue and current expenditure, the Treasury can arrange to keep its balance approximately stable. The Bank of England also uses the 'tap' method' of taking up new Treasury Bills, but the discount *rate in this case does not affect the discount market* at all. The Treasury Bill method of government financing has almost come to be considered as an essential adjunct to a Central Bank structure.*

In India Treasury Bills have been issued since 1917 at a discount. The main purpose of their issue during the Great War was the meeting of expenses, on behalf of the War Office in England, in purchasing the primary products and

* *Sayers : Modern Banking.*

War materials from India. In the post-war depression they were issued to meet budget deficits and to pay old bills, and now they are issued to meet current and capital expenditure, to pay off old bills, and to convert loans Their weekly sale by tenders by the Government through the Reserve Bank of India at its various offices withdraws funds from the money market, causes tight money, and leads to competition with banks and industries in raising funds. Thus, their issue and withdrawal causing deflation and inflation exercises a considerable control over the money market and the bank rate. They provide a secure, profitable, and liquid form of investment to the commercial banks in India specially during the slack season and make up to some extent the deficiency of bill discounting in the country.

CHAPTER VII

BANKING ACCOUNTS

Money can be ordinary deposited into and withdrawn from the following accounts in a bank:—

1. Fixed Deposit or Deposit Account.
2. Drawing or Current Account.
3. Savings Bank Account.

(1) In the first case money deposited cannot be withdrawn without a previous notice which may vary according to the term of the deposit. Usually

the deposits are for three months to five years, and the notice may be weekly or fortnightly, or monthly. Banks usually allow interest on these accounts because the money can be profitably utilised by them in any way they like for the period of the deposit. By taking money on deposit the bank provides for its safe custody, but the money is not set apart in a safe in the strong room ; it is replaced by a debt due from the bank. The deposit account in fact provides a temporary investment for money on which interest is payable so long as the money is not withdrawn and the principal is payable only when a regular claim is made by the depositor by giving a due notice as per the term of the deposit. The rate of interest usually varies from 2 or 3% to 6% according to the goodwill and status of the bank concerned and the term and the amount of the deposit and conditions of the market.

A person desirous of opening a fixed deposit account with a bank will first of all ask for quotation of the interest and the details of the terms under which the bank undertakes to take money on deposit. If he agrees to the terms and accepts the rate of interest he is supplied with a printed form to be filled up by him. The details relate to the name of the person, the rate of interest, the amount of money deposited, the period of the deposit and the period of the notice. He is also called upon to furnish a specimen signature of his own and in lieu of the form he gets a Deposit Receipt containing the above details. When the depositor desires to withdraw his money he is called upon to surrender this receipt at the expiry of the term

FIXED DEPOSIT RECEIPT

NOT TRANSFERABLE

The Allahabad Bank Limited, Cawnpore.

No. 4695

Received from Mr. Krishna Chandra Srivastava the sum of Five thousand Rupees to be placed to his credit on deposit for two years from 1st August, 1942 Repayable on the 1st August, 1944. Interest will be allowed at 3 per cent per annum.

For and on behalf of the Allahabad

Rs. 5000/-/-	Bank Ltd.,
M. N. Malhotra,	A. C. Curtis,
Accountant.	*Manager.*

N. B. This receipt must be given up on repayment of the amount.

of the deposit and is paid back the principal together with the interest to-date. Or, if he wants the deposit to continue then the receipt is renewed.

(2) The drawing or current account is usually opened by the bank for its customers into which sums of money can be deposited and withdrawn daily during business hours without any notice. Good banks usually don't allow *any interest* on them, but occasionally some banks allow a small interest (1 or 2%) provided the minimum balance does not fall below a certain fixed amount.* If the balance falls below the minimum, the banker usually charges a commission based on the

**Tannan: Banking Law and Practice in India*, p. 132.

annual turnover.* Unlike the deposit a/cs., where the banker knows his liability, he has to keep larger reserves to meet emergent calls and experience is his only guide in this respect. In this case the banker has a much greater responsibility, because the acceptance of deposits on this a/c. creates demand obligations to the customers which must be honoured so long as funds are to the credit of the depositor, and his order for withdrawal *i. e.*, cheque is in order. Such deposits do not add so much to the working capital of the bank as do the fixed deposits. The banker has to keep his funds in a liquid form and in adequate amounts to be able to meet these demand obligations and sometimes he has to suffer losses. Such accounts are very useful to merchants and businessmen for making payments and for collection of funds from debtors and buyers.

Before the opening of the account, however, a banker has to undergo certain preliminaries, enquiring about the financial stability, the conduct and business-like dealings of his customers. He must be satisfied through confidential and reliable

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*"*In India, most banks allow 2 p. c. interest on minimum daily or monthly balance of Rs. 300 to 1000 provided the interest accrued in a half year is not less than Rs. 3 to 5. It was reduced to 1 p. c. in 1933 on account of the economic depression. Banks make special arrangement with the customers when the amount of the deposit exceeds Rs. 1 lakh...... ...This practice enables the banks freely to use the minimum balance fixed on the account without running any great risk.*" *Joint Stock Banking in India* by *D. S. Savkar, p. 109.*

queries that the customer is a man of substance and not of straw. The inquiry about the financial stability of the would-be customer is made in various ways as a safeguard against fraud and against an inadvertent overdraft. Moreover, the banker has to supply confidential information about his customer's status etc., to other bankers and if he has failed to inquire at the time of opening the a/c. he may be precluded from the statutory protection to the collecting banker as per sec. 131 of N. I. Act. In most cases new customers are introduced to the manager of the bank by persons who are already its customers, or who are personally known to him by repute. In the absence of an introduction, a reference is given through which confidential enquiries are made and if the reply is satisfactory, a cheque book is given to the customer. If in the meantime cash and cheques are paid by the new customer into his credit, they should be accepted by the bank, but he should not be allowed to draw against such cheques until they are actually cleared.

Just as in case of a Savings Bank A/c, when a person has to open a current A/c with the bank, he has to put in an application and has to fill in a form in which he should write his full name, address and occupation. A similar entry is to be made by him in the Autograph Book or the Signature Book or on a card. It contains the specimen signature of the customer either in full or in abbreviated form. The purpose of the specimen signature is that, when cheques drawn by the customer are presented for payment, the signatures are

to be compared to prevent fraud and the amount from falling into unauthorised hands. If the customer is a Partnership firm each partner should sign both his own and the firm's name, and at the heading of the firm's account in the Ledger, the names of the individual partners should be recorded. If the customer is a public joint stock company, the certificate of Registration should be produced together with a copy of the Memorandum and the Articles of Association. For signature a certified copy of the resolution of the Board of Directors together with a specimen of the signatures of the Directers authorised to sign should be supplied to the bank. A similar procedure is to be followed in accounts of municipalities, district boards, notified areas, port trusts, and Improvement Trusts etc. In case of associations formed for political, social, charitable and other purposes accounts are opened usually in the name of the Treasurer under a resolution passed by the Executive Committee and signed by the Chairman. On the receipt of a notice of death or insolvency of a customer all payments of the accounts should be stopped. It is not the fact of death but the receipt of notice of death that cancels the banker's authority to pay, and if he pays before receiving notice, he is entitled to charge the amount to the account. In case of lunacy the account can be operated upon by the committee appointed by the Commissioners of lunacy.

After going into these preliminaries and having satisfied himself with regard to the respectability and status of the customer, the banker opens a

Pay-in-slip

______________19 .

PARTICULARS of remittance for credit of ____________________ account

with

ALLAHABAD BANK LIMITED.

Affiliated to the Chartered Bank of India, Australia and China.

	Rs.	A.	P.
Cheques on the Bank			
Cheques on other Banks			
Out-Station Cheques			
Currency Notes ...			
Silver			
Treasury Orders ...			
Total ...			

Signature.

______________19 .

PARTICULARS of remittance for credit of ____________________ account

with

ALLAHABAD BANK LIMITED.

Affiliated to the Chartered Bank of India, Australia and China.

	Rs.	A.	P.
Cheques on the Bank			
Cheques on other Banks			
Out-Station Cheques ...			
Currency Notes ...			
Silver			
Treasury Orders ...			
Total ...			

Signature.

current account in the name of the customer, and supplies him with the following books :—

(a) A Pay-in-slip Book.

(b) A Bank Pass Book.

(c) A Cheque Book.

The Pay-in-slip Book:—It is a small but well-bound book containing a number of printed slips specifying particulars of payment in notes, silver, gold, cheques and drafts made by the customer for being credited to his account in the bank whenever he remits money to the bank for this purpose. Every slip is perforated in the middle and similar entries are made on both the foils and the counterfoils, it is dated and signed by the customer and by the cashier of the bank. A reference of the Ledger folio to facilitate transfer entries is also given. The foil is retained by the bank cashier while the counterfoil after being signed by the cashier is returned to the customer for reference. Some banks supply loose slips.

The Pass Book:—It is a book in which full particulars of deposits, withdrawals, interests and charges are recorded in a chronological order at the bank. Its ruling is similar to the Savings Bank A/c but it is not necessary to send it every time a transaction is made to the bank. However, it is very useful and necessary to send it to the bank at least once a month so that the balance of the pass book may be compared with the bank balance in the Ledger. Sometimes there is a divergence between the balance of the pass book and the balance in the Ledger A/c of the depositor and it is

PASS BOOK

*Name*____________________________

*Address*____________________________

IN CURRENT ACCOUNT WITH

The Central Bank of India, Ltd., Cawnpore.

Date	Particulars	Cheque No.	Dr.	Sig.	Cr.	Dr. or Cr.	Balance
	Carried forward Rs. ...						

due to the following causes. *Firstly*, cheques paid into the bank for collection and credit into the customer's account are not collected and credited the same day they are sent, and therefore, the banker does not credit the account with the amount of such cheques, but the customer has taken account of them in his cash book. *Secondly*, cheques issued by the customers are not immediately presented by the persons concerned for payment, and this again causes a difference. *Thirdly*, the banker credits the account of the depositor with interest or debits for charges but does not advise of the same to the customer. To reconcile this discrepancy a statement is prepared which is called *Bonk Reconciliation Statement.* To the balance shown by the Pass Book the amount of cheques paid in but not cleared are added, and then from the total, the amount of cheques paid but not presented is deducted, and then the balance agrees with the balance of the Bank column of the Cash Book.

The Cheque Book :—It is the most important book and contains printed cheque forms which are to be utilised by the customer for withdrawing money or ordering payments to be made to his creditors. It is supplied by the banker to all his customers free of charge and contains a number of leaves. Each leaf has two parts: a foil and a counterfoil, both of which bear similar distinct numbers. The drawer fills up both the foils and the counter-foils, issues the foil to the payee of the cheque and retains the counterfoil for ready reference in future. The details with regard to date, parties, the amount and signature of the

drawer are recorded on both the parts. At the end of every book there is a printed slip containing a request which the customer is required to fill up and send for another book when one is exhausted. On every page there is the name of the bank printed on it.

Legally speaking the drawer can utilise an ordinary piece of paper for withdrawing an amount from his current account, and in England most banks usually honour such cheques and some banks in India do the same*. Law does not lay down that only printed forms are to be utilised, but all banks, through the rules in the application form which a customer is required to sign at the time of opening an account, make it obligatory on his part to draw cheques on their printed forms only, and in such cases the banker is justified in dishonouring cheques drawn on other than the printed forms. On similar grounds it is desirable that the customer should not use the printed forms supplied to other customers and especially so when every cheque book supplied to a customer these days bears a distinct number which facilitates the tracing of the account of the customer, and helps in detection of forgery. Moreover, a cheque book must be kept under lock and key to minimise the chances of forgery.

There are a number of advantages arising from the use of printed forms of cheques. *Firstly*, it makes forgery very difficult by making it necessary to obtain the printed form before the

*Tannan : *Banking Law and Practice in India*, p 168.

name of the drawer can be forged, by making the detection of alterations in amount more convenient, and by affording a ready reference to the banker for finding out the name of the drawer if the signature is not legible. *Secondly,* it saves the trouble of drafting cheques in accordance with law. *Thirdly,* the drawer can stop the payment of the cheque very easily by only giving him its number. *Fourthly,* the counterfoils will be used as a record of the various payments made by the customer and this will help him in checking his account.

Payment by cheques is very convenient and less risky than cash; the cheques can be drawn for any amount and crossings on them render them very safe. They dispense with the necessity of taking receipts from payees although legal receipts from them should be taken. Cheques also avoid the necessity of maintaining records of receipts and payments which are kept on their behalf by the banks. They serve as evidence of payments and statements of accounts from banks can be produced in law courts. They have effected a great economy in the use of metallic and paper currency, saved them from wear and tear and facilitated the settlement of mutual debts without the passing of currency. In India, however, cheque currency is as yet not so popular because of paucity of bank offices, writing of cheques in English, lack of confidence in banks, lack of adequate facilities for encashment and of proper appreciation of its advantages. Moreover, stamp duty on cheques upto 1927 prevented their free use by the public.

Savings Bank Account :—Persons with small savings to invest and not requiring money daily but occasionally can get this account opened. Money can be deposited and withdrawn form this account usually once or twice a week and a small interest is allowed on the minimum monthly balance usually from the 4th to the last date of the month. At present this interest is allowed at $1\frac{1}{2}\%$. Withdrawals are restricted to Rs. 100 a week but larger withdrawals can be made by giving two weeks' notice, but it can not be beyond Rs. 500 a month. Such an account encourages the habit of thrift and self-help among the people. It is in the main governed by the same principles as the Post Office Savings Bank Account with the additional advantage that the account can be operated upon by means of cheques, although most banks in India do not allow it. The Central Bank of India and the Allahabad Bank, however, allow this facility. No overdraft is allowed on Savings Bank A/c., but facilities for collection of cheques and safe custody deposits are given. Moreover, a very small reserve is required in these A/cs.

On exactly similar principles some joint stock banks open what are called *Home Safe A/cs* in which small iron safes safely locked up are handed over to the depositors, who daily or weekly drop in them their small savings, and send them on to the bank for crediting their accounts. These safes are particularly useful in places where no bank office is situated, and they are capable of impressing the advantages of thrift and saving in a very practical

manner on the masses. The keys of the safes are kept by the bank.

The procedure in opening the savings bank A/c is the same as in the Post Office. The would-be depositor is supplied with a printed copy of the rules and regulations together with a form of declaration, in which he has to state that he has read carefully all those rules and understood them. Then he gives his name and address and a specimen of his signature which is kept for future use, whenever he withdraws money from the account. On the opening of the account he is supplied with a Pass Book in which all deposits and withdrawals are recorded in a chronological order and every transaction is initialled by the cashier concerned. For withdrawals he is supplied with printed withdrawal forms which are to be filled and presented by him personally or through a messenger.

It was proposed by some witnesses before the C. B. Inquiry Committee that in addition to these forms of cash deposits, banks should be persuaded to receive "provident deposits" for a long period of about 10 years, to encourage those who wanted to provide funds for specific purposes like marriages and education of children or for business capital and thus increase opportunities for investments. The Committee also made a number of suggestions to regulate banking in the interest of depositors. The banks must publish their accounts duly audited by qualified auditors; maintain reasonable cash ratios, and follow a judicious plan of investment of funds. They should give publicity to their A/cs

and should educate the investors in the advantages of various deposits to increase their working capital.

BALANCE SHEET OF A BANK

Liabilities	Assets
Capital :—	Cash in Hand and at the Bank.
Authorised.	
Subscribed	Money at Call and Short Notice.
Called up.	
Paid up.	Bills Discounted.
Reserve Fund.	
Deposits :—	Investments in Securities.
Current	Loans and Advances, Cash credits and overdrafts.
Fixed and Savings Bank.	
Others.	B/R or *Acceptances* for *Customers* as per contra
Liabilities for Customers' Acceptances as per contra.	
Unclaimed Dividends.	
P. and L. A/C Balance.	Premises and Dead Stock.

A Balance Sheet is a periodical statement of accounts setting forth the financial position of a Bank as on a particular date. Banks practise a good deal of 'window-dressing' in preparing their Balance Sheet and a proper understanding of the various items appearing in it is essential for finding out the true state of affairs of the Bank concerned. The left hand side shows the Liabilities i. e. what the Bank owes to its shareholders, customers or depositors and others ; and the right hand side shows the Assets i. e. what others owe to it and the total of its claims and properties in investments, cash, bills etc. etc.

Liabilities :—Authorised capital means the maximum amount of capital which the bank is allowed by its Memorandum and Articles of Association to raise from the public.

Issued Capital means that part of the Authorised capital which is issued to the public for subscription

Subscribed Capital means the amount of the issued capital subscribed by the public.

Called up Capital refers to the amount of subscribed capital called up; whereas *Paid up Capital* refers to the amount actually paid up by the shareholders on the shares purchased by them. The uncalled amount on the shares subscribed is called the *Reserve Liability of Shareholders.*

Reserve fund refers to the accumulation of undivided profits of the bank which do the work of additional working capital. It is created out of the annual profits for meeting contingencies and strengthening the financial position of the bank.

Deposits refer to sums of money deposited by the customers of the bank either on current, fixed or savings bank accounts. They have already been discussed earlier in this chapter.

Liability for customers' acceptances :—It is a temporary liability incurred by the bank in accepting bills of exchange on behalf of its customers. The bank in turn can get the same amount from its customers against whom it has a claim. An exactly similar amount therefore appears on the Assets side under the caption

IMPERIAL BANK OF INDIA LTD.

Balance Sheet as at 21st, June 1940

Liabilities			Assets		
Paid up Capital	Rs.	5,62,50,000	Cash in hand and with the Reserve Bank	Rs.	10,03,41,000
Reserve Fund	,,	5,60,00,000	Balances with other Banks	,,	45,59,000
Fixed deposits Savings Bank etc.	,,	87,75,13,000	Investments in gilt-edged	,,	35,77,21,000
Acceptances for constituents	,,	36,000	Other Investments	,,	97,23,000
Sundries	,,	1,57,89,000	Advances and loans	,,	8,43,28,000
			Cash credits and overdrafts	,,	37,78,98,000
			Bills discounted and purchased	,,	4,37,74,000
			Liability of constituents per contra	,,	36,000
			Dead Stock	,,	1,83,77,000
			Sundries	,,	88,31,000
	Rs.	1,00,55,88,000		Rs.	1,00,55,88,000

In fact, as said above, cheques are the most prevalent form of media of exchange in these countries and even in India in the big industrial and commercial centres like Calcutta, Bombay, Delhi, Cawnpore etc., cheques have come into general vogue as a popular and economical form of medium of circulation and exchange.

A Negotiable Instrument, as per the English Bills of Exchange Act, has been defined as a "document in writing which by endorsement and delivery, or by mere delivery, passes the full title to the benefit of the instrument to the transferee, who takes it *bona fide,* and for value, irrespective of any defect in the transferor's title, and upon which the holder in due course can sue in his own name." According to the Indian Negotiable Instruments Act, a negotiable instrument means a promissory note, bill of exchange, or cheque payable either to order or to bearer. Besides these three instruments, the Law Merchant or mercantile usage recognizes other documents also as coming within the category of negotiable instruments *e. g.* Hundies, Bills of Lading, Dock Warrants, Delivery Orders, Share Certificates, etc. But there is one fundamental difference between these documents and the first three, and it is that the holder of these documents can sue in his own name and recover the debt, but he cannot get a better title to them than the transferor. On the other hand, the holder in due course of a cheque, bill of exchange and promissory note acquires a good title to the instrument, no matter whether the title of the transferor is good or defective. That

is why they are popularly termed as semi or *quasi* negotiable instruments. A consideration of the above definitions brings out clearly the salient features of the negotiable instruments.

Firstly, it is an instrument *i. e. it is in writing and not oral.*

Secondly, *the property in it passes from hand to hand either by delivery, if it is payable to bearer, or by indorsement coupled with delivery, if payable to order.*

Thirdly, *the transferee who takes it in good faith and for a valuable consideration acquires a good title irrespective of the transferor's title being defective.*

Fourthly—*The holder in due course can sue upon it in his own name.*

Holder in due course :—A holder in due course is a person who takes a bill complete and regular on the face of it, before it is overdue, *bona fide* and for value, without noticing any defect in the title of the transferor, and upon which he is liable to sue in his own name. According to the Indian Negotiable Instruments Act, a holder in due course means any person, who for consideration, became the possessor of a promissory note, bill of exchange or cheque, if payable to bearer, or the payee or indorsee thereof, if payable to order, before the amount mentioned in it became payable, and without having sufficient cause to believe that any defect existed in the title of the person from whom he derived his title. Formerly the holder in due course referred to 'the *bona fide* holder for

value without notice'—a statement which though long and cumbersome was nonetheless self-explanatory. An analysis of the definition brings out clearly the chief features of a holder in due course as distinguished from a mere holder for value. To be a holder in due course, and to be entitled to the privileges thereof, the holder of the bill *must take it before its maturity,* he must take it only when it is *complete and regular in form,* he must take it *in good faith,* and he must take it *for a valuable consideration either past or present,* and he must have *no reason to believe that the title of the transferor is defective.* Under these circumstances his title is quite free from defects in the transferor's title and *he can sue upon the bill in his own name.*

A holder for value is not the same thing as a holder in due course. A donee of a bill, for example, is a holder but not a holder in due course, because he has not taken the bill for a valuable consideration, or in other words, he has not himself paid value for it ; his title is not better than that of the transferor, and he cannot sue upon the bill in his own name. However, if the donor is a holder in due course then the title of the donee will be good A holder must act honestly, and with diligence and care. Sec. 58 of the N. I. Act further clears the position of the holder in due course as follows :—

"When a negotiable instrument has been lost or has been obtained from any maker, acceptor or holder thereof by means of an offence or fraud or for an unlawful consideration, no possessor or

endorsee, who claims through the person who found or so obtained the instrument, is entitled to receive the amount due thereon from such maker, acceptor or holder, or from any party prior to such holder, unless such possessor or indorsee is, or some person through whom he claims was, a holder thereof it due course."

Ordinarily speaking theft or forgery gives no title, but in case of a bearer instrument the transferee, if he takes it in good faith and for a valuable consideration, as also, others who claim through him, acquires a good title. The same is true in case of the finder of a lost instrument. However, if the instrument is payable to order, no transferee getting it through the finder or the thief or the forger, will acquire a good title.

Cheque:—A cheque is a B/E drawn on a specified banker payable always on demand. According to section 6 of the N. I. Act, "A cheque is a bill of exchange drawn on a specified banker and not expressed to be payable otherwise than on demand." Whereas a Bill of Exchange as per sec. 5 of the same Act is "an instrument in writing containing an unconditional order, signed by the maker directing a certain person to pay a certain sum of money only to, or to the order of a certain person or to the bearer of the instrument." Hence, a cheque may be defined as an unconditional order in writing addressed by the customer of the bank, requiring the latter to pay a sum certain in money to, or to the order of a certain person, or to the bearer thereof, on presentation of that order. The

presentation, however, must be made within six *months of the date of issue, and that too, on business* days during business hours. The business hours are from 10 A. M. to 3 P. M. on other days, and from 10 a. m. to 1. p. m. on Saturdays.

While elucidating the definition of the bill of exchange, the Act gives the following explanations: "A promise or order to pay is not 'conditional' within the meaning of this section and sec. 4, by reason of the time for payment of the amount or any instalment thereof being expressed to be on the lapse of a certain period after the occurrence of a specified event which, according to the ordinary expectation of mankind, is certain to happen, although the time of its happening may be uncertain." For example, a bill payable on the death of a certain person is in order, whereas that on the *marriage of a* certain person is not, because he may not marry at all in his life, but death is sure to happen some day. Further, "The sum payable may be 'certain' within the meaning of this section *and sec.* 4, *although it includes future interest* or is payable at an indicated rate of exchange, or is according to the course of exchange, and although the instrument provides that, on default of payment of an instalment, the balance unpaid shall become due." "The person to whom it is clear that the direction is given or that payment is to be made may be a certain person, within the meaning of this section and sec. 4, even if he is misnamed or designated by description only." For example, a cheque payable to the Games Superintendent of a College, or to its Principal, or to the

Head Master of a School, or Treasurer of an association or a club etc, may be regarded as payable to a certain person. Further even if the person is misnamed or designated by description only, the cheque will not be out of order on this very score.

Essentials of a Cheque

1. It must be an instrument *i. e. it must be in writing and not oral. It may be written by pen or pencil or may be typewritten or printed*, but in order to prevent unauthorised alterations which can be easily made by an erasure, and can be detected with great difficulty, and in order to avoid risks, *the banker should not accept cheques written in pencil.*

2. The instrument *must contain an unconditional order*. An explanation of the order being unconditional has been given above. But it must be remembered that if the instrument contains an order to do something more in addition to the payment of an amount expressed clearly it will be a conditional order, and hence not a cheque.

3. It must be *drawn upon a particular banker and not on any person or a debtor.* As regards bank's drafts there is a difference between English and Indian Law. According to the English law the drawer and the drawee must be two distinct persons and therefore the bank draft will not be regarded as a cheque. But in case of Indian Law it is not so, and therefore, drafts from the head office of a bank to its branch and *vice*

generally treated as bearer cheques. But cheques drawn payable to impersonal payees such as 'Income Tax or order' must on no account be treated as payable to bearer. Such cheques require the endorsement of the Income tax Collector or some other Income tax authority authorised to receive payment of such cheques. Cheques drawn to 'self' are payable to the drawer. If the cheque is made payable to a certain payee only, the word 'only' must be added after his name and the words 'Order' or 'bearer' should be struck off.

Amount:—It has already been stated that the amount of the cheque *must be written clearly and legibly both in words and figures* so as to avoid mistakes. While writing the amount the drawer must take care that he does not leave sufficient space in between the Rupees and the amount at both the places, otherwise there is a risk of the amount being increased by a fraudulent holder in such a manner that it cannot be detected. Similarly, no space should be left out between the dash and the figure. *If the paying banker is unable to find out any alteration in the amount after exercising due care and diligence and pays the altered amount, he shall be entitled to debit the account, of the drawer with the amount enhanced.* It is in order to avoid such a possibility that the drawer writes phrases like 'Under two hundred rupees' or 'Below rupees five hundred' on the face of the cheque or across it, or better still, the amount is perforated by a perforating machine or protectographs and special papers are used. Further, the amount both in words and figures

with them and the same is stamped on every page of the cheque book. This practice facilitates the finding out of the name of the drawer, whenever there is a fear that the signature is not genuine, or that it does not tally. In case of illiterate persons cheques can be signed or endorsed by means of marks witnessed by a person known to the banker in his presence. Such a witness should not be the employee of the bank. Similarly in case of serious illness the mark of the sick man should be witnessed by his doctor, who should give a certificate that the drawer was too ill to sign the cheque.

A cheque on which the signature of the drawer has been forged is known as a forged cheque. If the banker pays such a cheque he cannot debit the account of the customer with the amount so paid, but will have to bear the loss himself. Even if the banker exercises due care and diligence and is unable to detect the forgery, he incurs a personal liability. The banker has no statutory protection if he pays a cheque with forged signature of the drawer, howsoever care and diligence he may have exercised, because in that case "he has no legal authority form his customer to part with his funds."* If the drawer has contributed through his negligence to the commission of the forgery *e g.*, by not keeping the cheque book under lock and key as required by the banker, the banker is exonerated from liability, provided he made the payment in due course and without negligence. The onus of proof that he has acted in good faith lies on the shoulder of the banker.

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*Tannan: *Law and Practice of Banking, p. 230*

Parties to a cheque:—There are three parties to a cheque, the drawer, the drawee,and the payee. The *drawer* is the customer of the bank who writes out the order to pay ; the *drawee* is the bank on whom the cheque is drawn ; and the *payee* is the person to whom the cheque is payable.

The primary liability on a cheque is that of the drawee on whom it is drawn, but the drawer by drawing and negotiating the cheque incurs a contingent liability, and it is that, in the event of dishonour by the bank, the holder in due course can claim from him as well as from every previous endorser, provided the holder in due course was not guilty of not presenting the cheque within a reasonable time during business hours. and that the banker had no sufficient funds to the credit of of the drawer. If the funds were sufficient to meet the cheque, but the holder did not present it within reasonable time, and the banker in the meantime fails, he cannot proceed against the drawer, but will claim as a creditor of the bank and will get in composition like other creditors. To make his claim valid the holder in due course must give a due notice of dishonour to all the previous parties. The contingent liability being in an ascending order the ultimate responsibility is that of the drawer.

Classification of cheques :—Cheques are usually classified into an *order or a bearer cheque,* and again, in an *open* or a *crossed cheque*. An order cheque is one which is made payable to a certain person or to his order and, before it can be negotiated futher, it must be endorsed by the payee and

delivered to the transferee. For example, a cheque payable to Rameshwar Swarup must be signed by him on the back, after the direction as to whom it is to be paid, before it can be negotiated. On the other hand a Bearer cheque is one which is payable to anybody who presents it across the counter of the bank and which can be negotiated only by delivery. However, as a matter of banking practice the bearer is required to sign his name on the back of the cheque before he can be given the amount. It is done only as a safeguard.

An open cheque is one which can be presented by the payee or his messenger in person to the bank on whom it is drawn and which can be cashed across the counter. It does not bear any crossing. To open a cheque, therefore, means to cancel the crossing on it and such a change must be initialled by the drawer. Such a cheque is, however, very risky, because if it is lost, anybody can get it cashed over the counter, if it is a Bearer one, and even if it is an order cheque, it can be easily cashed by forging the endorsement on it. A bearer cheque is therefore very unsafe as fraud can be easily committed on it and an Order cheque is a bit safer.

A crossed cheque is one which bears two transverse parallel lines across its face with or without certain words in between. It is much safer than an open cheque inasmuch as the amount of the cheque cannot be obtained by any body over the counter on presentation by him ; it must be presented through a bank, and hence the chances of forgery or fraud are minimised.

Crossing is of two kinds; (a) *General* and (b) *Special.* In the first only two transverse parallel lines with or without words like, "& Co." "Not Negotiable." "Under Hundred Rupees" etc. are drawn across its face, the effect of which is that the amount of the cheque will be paid through a bank only. Whereas in the second case, in addition to the two transverse parallel lines with or without words 'Not Negotiable' the name of a specified bank is written in between the lines, the effect of which is that the drawee bank will make the payment only to the bank whose name is mentioned in the crossing. Such a specially crossed cheque is still safer than the generally crossed one. Some times in addition to the crossing on it, a cheque bears the phrase 'Account Payee only'. The significance of this phrase is that the amount is not only to be paid through a bank, or through the particular bank named in the crossing, but that the amount should not be paid at all; it must be kept to the credit of the account of the payee in the books of the collecting bank. It is still safer than a simply specially crossed cheque.

Not Negotiable :—The words 'Not Negotiable' may form part of any crossing, and when they appear on a cheque with a crossing they take away its futher *negotiability* but not its *transferability*. A cheque marked 'not negotiable' can be transferred only to a known party, and even then the transferee cannot have nor give a better title than the transferor from whom he took it had. These words constitute a warning to the transferee to beware of the transferor. Ordinarily speaking the holder

in due course of a cheque is free from any defect in the title of the transferor, but when a cheque is marked 'not negotiable' this immunity of the holder in due course from the defects in the title of the transferor is destroyed. Even if the holder has paid value for the cheque and has taken it in good faith, he cannot claim on it from the drawee bank, if the title of the transferor is defective. If by inadvertence or oversight the drawee bank pays the amount of the cheque to its holder, and it is found that the cheque was stolen by the transferor, then the amount of the cheque will have to be returned to its original rightful owner*. If the words 'Not Negotiable' do not form part of a crossing, they do not restrict the negotiability of the cheque and lose their significance. Thus, it is clear that a cheque marked 'not negotiable' and crossed specially with the phrase 'Account Payee Only' is the safest possible cheque.

It may be useful to point out here that a 'Bearer' cheque can be made safer in the following ways :—

1. By changing it from 'bearer' to 'order.'
2. By restrictive endorsement.
3. By crossing it generally.
4. By crossing it specially.

*"*The effect of adding the words 'not negotiable' to a cheque is not to impede transfer, but to perpetuate in the hands of any transferee whatever defect or infirmity of title may affect the person who first transferred the cheque with those words on it.*" *Lord Halsbury.*

5. By marking it 'Not negotiable' in addition to crossing.

6. By requiring the amount to be credited to the account of the payee only instead of being given to him or to his agent over the counter in addition to special crossing and 'not negotiable'.

Mutilated cheque : A mutilated cheque is one which is torn into pieces and pasted together. If the drawer accidentally tears a cheque into two he should paste the parts together again and write across the back "accidentally torn" and sign it. A mutilated cheque on which the figures cannot be read clearly will not be paid by the banker.

If it is mutilated by the holder or the payee by mistake, confirmation by the drawer or a guarantee by the payee's banker should be obtained.

If a mutilated cheque is presented for payment *without the confirmation of the drawer*, the paying banker should return it marked "Mutilated Cheque." What is required in this case is that a mutilated cheque should either bear the confirmation of the drawer, or if the mutilation has been accidental by the payee, the confirmation of a banker. A third person's confirmation to the mutilation will not protect the banker from loss, should it be proved that the drawer has cancelled the cheque by tearing it up.

Marked cheque : A marked cheque is one which is initialled by the drawee banker usually when it is presented after business hours signifying thereby that he has sufficient funds to the credit of the drawer and that it will be honoured when presented

for payment on the following business day or within a reasonable time. Sometimes words such as "Good for payment if presented before......" are inserted. *The effect of marking a cheque is to give*

EXAMPLES OF CROSSING

Special

1
Imperial Bank of India

2
Not negotiable
Imperial Bank of India

3
Imperial Bank of India
A/c payee only

General

1

2
& Co.

3
Not negotiable

4
& Co.
Not negotiable

5
*Under hundred Rupees

6
*A/c payee only

**Although such crossings are usually in vogue, they have no statutory sanction.*

it an additional reliability or currency by adding on its face the credit of the drawee banker to that of the drawer

Cheques are marked (*a*) at the instance of the drawer, (*b*) at the instance of the payee, (*c*) at the instance of a collecting banker. (1) If a cheque is marked at the request of the drawer or the customer the drawer cannot countermand or stop payment of the cheque without holding himself liable to indemnify the banker for any loss he may suffer by his stopping payment afterwards. (2) The marking of cheques at the instance of the holder is quite common in America and not in India or England. Marking in such cases does not constitute anything more than an intimation that at the time of marking, the banker has a sufficient balance to the credit of the drawer. A better practice under such circumstances is to obtain from the banker a bank draft in exchange for the cheque. (3) Cheques are most commonly marked at the request of the collecting banker, when they are received too late in the day for clearance through the usual channels. In such a case marking constitutes a constructive payment as it imposes an obligation on the drawee banker to pay the cheque when presented and the drawer cannot effectively stop payment. There is a conflict of opinion on it.

Lost cheque:—If a cheque is lost the holder can obtain a duplicate from the drawer on giving a guarantee to indemnify him in the event of a loss. Immediately a cheque is lost, the holder should notify all parties to the cheque, and request the drawer to issue a duplicate, and to give a notice

to the drawee banker to stop payment. The holder cannot directly notify the drawee banker to stop the payment because there is no contractual relationship between them. The drawer should not issue a duplicate without proper indemnity, because if the cheque is a bearer one or an order cheque duly indorsed but not crossed 'not negotiable', and the finder transfers it to a person who takes it in good faith and for value, the drawer can be compelled to pay to such a transferee. Hence, the drawer would have to honour both the original and the duplicate and so requires an indemnity, on which he can recover, if necessary, the loser of the cheque bearing the loss. The holder of a lost bill can not claim payment on it, if the original has been paid.

Sometimes a cheque is sent through the post and lost in transit, therefore, it is desirable to send cheques through registered post with special crossing. Loss of cheques in transit raises a very interesting point of law as to the liability for it. Briefly stated the liability rests between the sender and the person to whom it is sent; and the determination of the liability depends upon the answer to the question as to which party makes the post office its agent If the drawer sends it by ordinary post without an express request from the payee, then he must take the risk of his remittance not arriving safely or at its destination, because, *prima facie* the post office is acting as his agent. On the other hand, if the cheque is sent through the post office at the definite request of the payee, then the post office becomes his agent, delivery to

it amounts to a constructive delivery to the payee himself, and as the property in the cheque passes to him as soon as it is posted, he must suffer the loss, if the cheque falls into the hands of a thief who succeeds in getting payment for it from the drawee banker. It applies to dividend warrants also.

Material Alterations on a cheque :—A cheque is said to be altered materially when on account of a change in date, place of payment, amount or the parties, it ceases to speak the same language in legal effect as originally intended. Such an alteration changes the legal identity or character of the cheque, either in terms, or the relation, of the parties thereto, and makes it void as against any party which does not consent to it, unless it is made to carry out the common intention of the original parties. Such a materially altered cheque may not be regarded as a cheque at all. It is clear, therefore, that such an alteration made by an endorsee without the consent of the endorser discharges the latter from all liability to him. A cheque which is materially altered with the consent of all the parties becomes a new cheque. The following changes are thought to be material alterations :—

(*a*) Change of the date and, therefore, of the time of payment ;

(*b*) Change in the amount of the cheque ;

(*c*) Change in the medium of payment ;

(*d*) Change in the rate of interest or of exchange ;

(*e*) Change in the place of payment ;

(*f*) Change in the number or relation or legal character of the parties ;

(*g*) Change from order to bearer ;

(*h*) Change from special to general crossing.

In the following cases, however, the holder of an instrument is not liable for any material alterations:—

(*a*) When he changes a blank endorsement into a special one ;

(*b*) When he crosses an open cheque ;

(*c*) When he crosses a generally crossed cheque specially ;

(*d*) When he adds the words 'not negotiable' to a general or special crossing ;

(*e*) When the banker crosses a specially crossed cheque to him for collection to another banker.

All material alterations on a cheque require the signature or initial of the drawer to confirm them. If there are more than one drawer, then all of them must sign or initial the changes. The drawee bank must see carefully that all such changes have been initialled or confirmed by the drawer and been made with his consent or authority. If the alteration is not apparent and he pays the cheque in good faith and without negligence, the payment is held in order.* *Except an alteration of the date all material alterations should bear the full signature of the drawer.* Full signature of the drawer on all material alterations,

* *Davar's Law & Practice of Banking, p. 36 & 69.*

however, is preferable. A banker would usually return the cheque if material alterations are not authenticated by full signature of the drawer, initials being liable to be forged, especially as a specimen of initials is not recorded and the banker is not accustomed to know them. Material alterations invalidate a cheque. If a *materially* altered cheque is paid without the drawer's consent, the *banker does so at his own risk.*

Endorsements

One of the chief characteristics of a cheque is its negotiability or transferability of ownership and property in it by delivery or endorsement and delivery. If the cheque is a bearer one its property is transferred to the transferee by mere delivery, but if it is an order cheque, it must be endorsed before its property can be transferred to another person on delivery to him. This endorsement is the act of signing one's name on the back of a cheque with the intention of transferring the property in it to another person and delivering it to him. Mere signature without the intention of transfer and delivery of the cheque to the transferee does not constitute an endorsement. And net delivery implies the acceptance of the cheque by the transferee, so that if the endorsee does not accept it there is no valid endorsement. If a principal signs a document and delivers it to his agent for safe custody it is not endorsement. For the same reason if *A* indorses a cheque to *B* and before he delivers it to him *A* dies, then the cheque must be endorsed again by his legal heirs, executors or administrators before it can be negotiated to *B*.

The N. I. Act defines endorsement as follows: "When the maker or holder of a negotiable instrument signs the same otherwise than as such maker, for the purpose of negotiation, on the back or face thereof or on a slip of paper annexed thereto he is said to endorse the same and is called the indorser." The emphasis in this definition is on the word *negotiation* which is quite different from *transfer*. The transfer of a thing from one person to another means a mere physical transfer of the thing but not its legal ownership, which remains vested in the transferor. But in case of a negotiation there is a transfer of the property in the thing transferred to the transferee who by its virtue can sue upon the thing in his own name and recover its value. Hence, the mere transfer of a negotiable instrument by the customer of a bank for safe custody does not lead to the transfer of property in it to the banker and therefore it is not an endorsement. Then the endorsement may be on the back or face of the cheque or it may be on a separate piece of paper attached thereto. As a general custom, endorsement is usually on the back of the cheque but it is lawful to have it on the face as well. When the back of the cheque is filled up with endorsements and there is no space left for further indorsements, then a slip of paper preferably of the same size, may be attached to it and the first endorser on the slip should so sign his name as to let the half of it appear on the attached slip and the other half on the main instrument, so that, if per chance it is detached from the instrument, it may not be

affixed to a cheque of higher or lower amount. Such a slip is technically known as 'Allonge'.

Endorsement can be made either by a holder or by his duly authorised agent, who must sign as to incur no personal liability, and if he is granted a power 'Per Pro.' or 'For' to the name of the principal and then sign it. If the holder is a joint stock company, then, it being a fictitious person, the endorsement must be done by the duly authorised director or secretary of the company who should also prefix 'for' or 'per pro' to his signature. In case of a firm any partner can make, draw or endorse an instrument but usually the work is entrusted to one or two partners. A minor can make, draw or endorse an instrument to bind others without incurring any personal liability on it. A bill can be negotiated indefinitely until it is discharged by the drawee or the acceptor, but not afterwards.

Endorsement can be made with a pencil or with pen and ink, but as a general rule, the bankers do not accept endorsements in pencil.

Broadly speaking, endorsement is of two kinds: *Blank or General* and *Special or full*. A blank or general endorsement is one in which the endorser only signs his name and does not direct to whom the amount is to be paid e. g., a cheque payable to Shiam Narain may be signed by him on its back as 'Shiam Narain'. The effect of such an endorsement is to change an order cheque into a bearer one. Whereas a Special or Full endorsement is one in which the endorser not only signs his name, but also gives a definite direction to the

drawee banker that he should pay the amount of the cheque to a certain person or to his order named by him *e. g*, if, in the first case, Mr. Shiam Narain writes 'Pay to Ram Narain' and signs his name beneath it, then the endorsement is full or special.

Besides these endorsements, however, there are other kinds of endorsements as well *Restrictive* endorsement is one which restricts or limits the further negotiation of the cheque or prohibits or excludes expressly its negotiation by the endorsee or makes him merely an agent to do as directed by the endorser; *e. g.*, if Shim Narain writes 'Pay to Ram Naram and him only' or 'pay Ram Narain for my use', or 'The within must be credited to Ram Narain' or 'Pay Ram Narain for the account of Uma Shankar' etc.

Sans Recourse Endorsement means *without recourse* endorsement : An endorser by putting his name on the back of a cheque guarantees to his endorsee that at the time of its delivery he had a valid title to it and that the cheque was genuine in every particular. He therefore incurs a contingent liability, and it is, that in the event of dishonour he would pay the amount of the cheque to the holder in due course if called upon to do so provided that a due notice of dishonour is given to him by the holder. If the endorser does not want to incur this contingent liability, he adds to his signature the words 'Sans Recourse' or 'Without recourse to me'. Then the endorsement is called Sans Recourse endorsement ; *e. g.*,

Pay Hari Shankar or order

Ram Kishore (Sans recourse)

Sometime the endorser adds some condition to his liability or makes it dependent on the happening of some event or the receipt of the payment by the endorsee is made dependent upon an event either precedent or subsequent, *e. g.*, 'Pay to Ramesh if he returns from America within six months'; or 'Pay to Ramesh when he attains the age of majority'. Such indorsements are called *conditional*.

Partial:—When the endorsement intends to transfer only a part of the amount to the endorsee, it is called a partial indorsement. But such indorsement does not operate as a negotiation of the bill. The endorsement must be of the entire bill to be valid and lawful. It may however authorise the endorsee to get the specified amount."*

Facultative endorsement is one in which the endorser waives his right to get a notice of dishonour to which he is entitled from a holder in due course. In the event of dishonour of a bill the holder is required to give a notice of dishonour to all the parties prior to him in order to bind them for their contingent liability, failing which all such parties are exonerated from liability to him. But if an endorser has endorsed it facultatively, then the failure to give a notice by the holder does not free him from contingent liability, *e. g.* Pay to Ram Chandra.

Notice of dishonour waived,

Ramakant Pande.

* *Davar's Law and Practice of Banking, p. 44.*

While endorsing the endorser must see to it that he writes his name in the same spelling as given in the indorsement even if it is wrongly spelt. However, if he likes he may sign in his usual way after signing in the wrong spelling; *e.g.*, if a cheque bears the following endorsement:

Pay Bindeshwari Prasad or order
Harish Chandra.

the correct endorsement will be

Pay Ram Gopal or order
Bindeshwari Prasad

or

Pay Ram Gopal or order
Bindeshwari Prasad
Vindeswari Prasad

But if he writes: Pay Ram Gopal or order
Vindeshwari Prasad

the endorsement will be incorrect and the cheque will be dishonoured. A cheque payable to Mrs. Srivastava should be endorsed

Kailash Srivastava or K. Srivastava.

but one payable to Mrs. J. P. Srivastava should be endorsed.

Kailash Srivastava, wife of J. P. Srivastava. A cheque payable to The British India Corporation Ltd., should be endorsed as,

Per Pro. The British India Corporation Ltd.
R. Menzies,
Managing Director.

A cheque payable to two sisters jointly must be endorsed by both individually. A cheque payable

to a woman received before her marriage should be endorsed by her as follows :

James Jackson nee Dorothy.

A cheque payable to an illiterate person should be endorsed:

(His thumb impression or mark)
Witness; Ram Bharosay,
11/207 Souterganj,
Cawnpore.

A cheque payable to the trustees of a deceased person should be endorsed by all the trustees on his behalf. Similarly a cheque payable to a man who dies before endorsing should be endorsed by his legal representative on his behalf. It is not necessary to write the Christian names in full but the initials must tally with the Christian name. Complimentary or courtesy titles like Babu, Lala Mr , Esquire, Miss, Sir, Dr. etc. are not written in endorsements.

Payment of Cheques

When a banker opens a current account for a customer he undertakes to meet all cheques drawn by him, provided they are presented within a reasonable time and there are sufficient funds to his credit, and there are no irregularities on the cheque. In fact it is one of the implied conditions of the contractual relationship of debtor and creditor between the two parties. But this duty is also imposed by the N. I. Act, which lays down that "the drawee of a cheque having sufficient funds of the drawer in his hands, properly applicable to the payment of such cheque, must pay

the cheque when duly required to do and in default of such payment must compensate the drawer for any loss or damage, caused by such default." And by mutual agreement this implied obligation may be extended to not only the amounts deposited by the customer but also to overdrafts granted by the bank. Moreover, the banker must have reasonable time to collect cheques sent to him before the drawer may be allowed to draw upon them. This obligation, however, does not prevent the banker from refusing to pay the cheque if it is not on popular form or is an ambiguous instrument or if the state of the customer's account does not permit of its being honoured. There are still a host of other circumstances and limitations in which a banker is justified in dishonouring the cheques of his customers. But the banker must be very careful in dishonouring cheques of his customers, because if he dishonours a cheque through negligence or inadvertence he may be called upon to pay substantial damages to his customer, if there were sufficient funds to meet it. The reputation of the customer is tarnished by dishonour of a cheque, and therefore, if there is a wrongful dishonour, the customer can claim damages or compensation. On the other hand, if he honours a cheque by mistake or oversight, when there is no sufficient fund to do so, he may lose the amount. Thus, a banker runs a very great risk is making payment on cheques. He must be very chary and cautious to safeguard his position and must not open an account for any customer without satisfactory introduction or references. Still while paying cheques he must take into consideration the following important points :—

1. Whether the cheque is an open or a crossed cheque.
2. Whether it is drawn on the particular branch at which it is presented.
3. Whether it is dated on a Sunday, or undated, or ante-dated or post-dated.
4. Whether it is drawn in proper and regular form.
5. Whether the amounts in words and figures agree.
6. Whether there are sufficient funds or not.
7. Whether the signature of the drawer is genuine.
8. Whether the endorsements on the cheque are in order.
9. Whether the cheque is mutilated.
10. Whether it is stale.
11. Whether there are any material alterations, and if so, are they confirmed by drawer's initials or signatures or not.

Under the following circumstances the banker will be justified in dishonouring cheques without any risk of compensation to the drawer :—

1. When amount in words and figures differs.
2. When funds are not sufficient or the cheque is for an amount higher than the amount of the overdraft.
3. When material alterations are not initialled by the drawer.

4. When the form of the cheque is not regular.
5. When endorsements are irregular.
6. When the cheque is mutilated.
7. When the cheque is undated, or post-dated.
8. When it is a stale cheque.
9. When a crossed cheque is presented over the counter.
10. When the drawer's signature is not similar to the specimen signature.
11. When effects are not cleared *i. e.*, cheques have not been collected.
12. When the account is closed.

To avoid misunderstanding bankers usually get printed slips with a detailed list of answers for dishonouring, number them, and the number of the answer is referred to as the cause of the dishonour. The following are some of the usual remarks on such slips:—

R. D. Refer to drawer.
N. S. Not sufficient.
N. F. No funds.
N. E. No effects.
E. N. C. Effects not cleared.
W. & F. D. Words and figures differ.
E. I. Endorsement irregular.
D. D. Drawer deceased.
N. A. No account.

Post-dated.

Out of date.

Drawer's signature differs.

Under the following conditions the banker must refuse to honour the cheques of his customer:—

1. *Drawer's countermand:* The obligation and authority of the banker to honour his customers' cheques are determined by the drawer's stopping the payment. On receipt of such a notice the banker must stop payment otherwish he will lose. However, if the drawer stops the payment by a telegram, the banker may require confirmation.
2. *Drawer's death:* The banker must be duly notified as to the fact of the drawer's death, otherwise, if he pays a cheque issued before the death of the drawer after his death, he can lawfully charge the account of the customer for want of a due notice. It is not the fact of death but the receipt of notice of death that effectively stops the banker's right to pay the cheque.
3. *Insolvency of the customer:* If the drawer's liabilities become greater than his assets he is said to be insolvent. If he is duly adjudicated as bankrupt by a court of law, and the banker gets a notice of a receiving order having been made against the customer, or of an act of bankruptcy by the customer, he must stop payment.
4. *Customer's Insanity:* If the customer becomes of unsound mind so that he is totally incapable of forming a rational judgment of his action

and the banker has learnt of it he must stop payment of all cheques. However, cheques issued prior to his insanity are valid and the payment of the same will be in order.

5. *Garnishee Order:* It is an injunction order issued by a court of law attaching the funds of the customer in the custody of the banker and requiring him not to honour any cheques drawn against them. On the receipt of such an order the banker must stop payment of cheques.

Payment in due course: When a banker has taken all precautions and considered all the points enumerated above and pays the cheque in due course he can legitimately debit the account of the customer with the same. The N. I. Act has defined payment in due course as follows :—

"Payment in due course means payment in accordance with the apparent tenor of the instrument, in good faith and without negligence, to any person in possession thereof under circumstances which do not afford a reasonable ground for believing that he is not entitled to receive payment of the amount therein mentioned." Hence, payment of a post-dated cheque is not payment in due course. Similarly payment of cheques with irregular endorsements, or of crossed cheques across the counter, of cheques bearing forged signatures are examples of the payment not being in due course.

CHAPTER IX

INDIAN MONEY MARKET

The development of trade, industry, commerce and agriculture is dependent on a cheap and adequate supply of credit, but a well-balanced and efficiently organised system of credit cannot develop without its indispensable concomitant—a well-developed money market. Finance or credit supply is the crux of all the economic problems of India, and one of the chief reasons for the lack of an adequate system of credit to meet the requirements of the country is the absence of a thoroughly organised and well-developed money market.

Money market is an institution or organisation which has to do with the purchase and sale of money and credit or "the rights to use money". Just as there is an ordinary cloth or grain market similarly there is a money market in which, although it sounds paradoxical, money and the 'rights to use money' are regularly bought and sold. The sellers in this market are the banks of various kinds having surplus loanable funds with them to sell or discount houses and individual bankers and shroffs, and the buyers consist of Govts. (central, provincial, local), businessmen and industrialists, firms and companies, agriculturists and traders. The stock in trade or the commodities of sale in this market are cash, bills of exchange, pronotes, stocks, and shares, bonds and securities,

bank notes, circular and other forms of letters of credit etc. The chief function of the money market is the supply of capital to finance trade, industry, commerce and agriculture. It acts as a link between the lenders of money and the borrowers thereof. Those people who have surplus wealth to save and invest, but are unable to find out suitable investments for themselves, and those who are in need of capital to undertake industrial enterprises and commercial ventures, are brought together through the agency of the money market. Thus, the pooling together of the small savings of the masses into a productive whole, and directing it into the productive channels, is the chief function of the money market. Another important function of the market is the stabilisation of currency and exchange by an effective control over currency, credit and banking through a central bank, and regularisation of the rate of discount or interest rates by equating the supply and demand of the media of exchange.

The Indian Money market is a very loose organisation, not well-knit, compact and perfectly organised. It lacks coherence and it is a misnomer to call it an Indian money market. Till lately there has been an absence of an organised money market in the urban centres and the rural areas are still devoid of any organised money market. Even the loose urban organisation has been hampered in its usefulness on account of stupendous difficulties. It is difficult to say if India even to-day possesses an all-India national money market. There are at least two chief

markets; one at Bombay, and the other at Calcutta and there are several smaller money markets like Cawnpore, Ahmedabad, Delhi, Lahore etc. The salient features of this market are :—

(i) *Absence of a well-knit and compact organisation.* The Indian money market has got *two sides—European and Indian.* The European side of the market consists of the Reserve Bank of India, the Imperial Bank and the Exchange bank and the bigger joint stock banks; while the Indian side consists of the smaller joint stock banks, the indigenous bankers, shroffs, and nidhies, co-operative societies and the rapacious money-lenders like the Kabulees, the Aroras, the Multanis the Mahajans etc. There is a *lack of co-operation and co-ordination among these constituents of the Indian money market.* They are independent units and carry on business individually on their own account. These two sides together constitute the supply side of the market. The demand side or the borrowers in the money market here are the Governments of the various provinces, and the central government, the local self governments or municipalities and district boards, port and improvement trusts, firms and companies, the industrialists and businessmen, cultivators and others, who borrow for the performance of social functions like marriages.

(ii) The most striking feature of the Indian money market is *the paucity of loanable funds.* There is not capital or credit enough to go round or

to meet all the demands of the market. This is due to *the universal prevalence of the hoarding habit, the grinding poverty and indigence of the masses, their improvidence and hopeless and chronic indebtedness and their ignorance and illiteracy.* Lack of thrift and investment habit is due to the *absence of suitable opportunities for investments in the form of adequate banking and credit facilities* to enrich the productive fields The existing banks have made very few systematic attempts to develop the money power of the country and have not yet realised the relative poverty of the people and the consequent value of small accounts. The *popularity of land as a form of investment* among the masses and classes of the country, the proverbial *shyness and timidity of Indian capital* which deters people from investing their surpluses in industrial undertakings and the *loss of public confidence caused by the banking failures* in the past, have prevented the mobility of capital from idle hoards into productive channels. On account of these reasons the quantity of mobile capital available for satisfying the needs of trade and industry is too small. As pointed out by the External Capital Committee "Indian capital is proverbially shy, timid, and requires to be drawn out." To draw out this timid capital lying idle in hoards there should be an all round development of banking and credit facilities and investment agencies to inculcate the habit of thrift and banking. No serious efforts have so far been made to

wean away the people from hoarding habit.

(*iii*) *Seasonal stringency in the money market and inelasticity of credit*: Before the establishment of the Reserve Bank of India currency and credit were divorced from each other. The banks had no power of note issue which was monopolised by the Government of India. The capacity of creating credit by the banks was restricted by the smallness of their cash holdings against demand obligations. To make matters still worse, the cheque system or deposit currency had not developed to a great extent to remove the inelasticity of the media of circulation. On account of this inelasticity the extra demand for currency during the season could not be met. Then the absence of a central bank co-ordinating the services of all credit agencies and centralising the reserves to tide over financial stringencies prevented the mobilisation of the scattered, independent reserves in times of emergencies. This system of dual control in which the supply of currency was monopolised by the government, and the banking and credit were left to regulate themselves caused grave inelasticity of both currency and credit. When the Imperial Bank of India came into existence it was to serve as a bankers' bank and a government bank and was supposed to regulate banking and credit, but it was not given the right of note issue. It is true that the Imperial Bank was authorised to borrow 12 crores from the Government of India to discount seasonal bills but it was much below the seasonal requirements of the market

and hence could not appreciably help in diminishing inelasticity and stringency. The result was that the bank rate used to jump up to 8 or 9% during the busy season, and hampered the growth of trade and business. But now Reserve Bank of India has through its monopoly of note-issue and its open market operations made the issue of additional currency automatic and relieved the seasonal stringency to a considerable extent. The Bank rate has remained stable at 3 p. c since November 28, 1935.

(iv) *Lack of an organised bill market and consequent rediscounting facilities*: It has further caused tightness in the money market. The commercial banks were not able to get accommodation from the Imperial Bank on this account and this fact limited their power of lending and financing business and trade of the country. It was expected that the Reserve Bank of India will be able to develop a bill market at an early date and provide rediscounting facilities on account of its receiving a deposit of 5% and 2% of the time and demand liabilities of the member banks, and thus lessen the inelasticity of credit and monetary stringency in the busy season. But so far the working of the Reserve Bank has not led to the fulfilment of this much desired improvement.

(v) Another important feature of the money market is the *lack of an effective control over the various constituents, their co-ordination and the consequent divergence between the Bank Rate, the Bazar Rate, The Imperial Bank*

Hundi Rate and *the discount rate.* Under these circumstances the bank rate cannot be effective and cannot serve as an index of the monetary conditions of the country. The Reserve Bank has not been able to bring all the various credit agencies under its aegis. All credit agencies should be linked with it.

(vi) The *preponderance of the usurious money-lender* is still another feature. Inspite of the co-operative credit movement being there for the last 35 years the money lender rules supreme in the countryside. He has still a virtual monopoly of credit supply in the village.

(vii) *No thorough study and specialisation of credit in its various forms*: There is an utter lack of suitable agencies to finance the special needs of agriculture, industry and commerce in the shape of land mortgage banks, industrial banks and discounting houses.

(viii) *Lack of development of branch banking*: The development of branch banking has been a pronounced tendency in the post-war period, but in India it is still conspicuous by its absence. The mofussil is not at all provided with any branch of a bank, while the overwhelming majority of the towns are also devoid of such facilities.

Banking habit and thrift are still undeveloped and the creation of the habit of investment is one of the most stupendous tasks before the joint stock banks of India. Mass illiteracy makes the problem still more difficult, whereas lack of an adequately

qualified technical staff and abject poverty of the people stand in the way of developing branch banking.

A study of the Indian Money Market in its various aspects brings out clearly the patent fact that *the development of banking and credit has not at all been commensurate with the size, the population and the resources of the country.* Now that the Reserve Bank of India has been established it may be hoped that the defects of the Indian money market will be gradually removed and in course of time we may have a well-organised and compact money market for the whole of India, provided all the credit agencies are linked with it and come under its supervision and control. It is lamentable that inspite of the working of the Reserve Bank for about a decade, this much desired and long hoped for improvement has not been effected as yet.

CHAPTER X

INDIGENOUS BANKS

The Indian Banking System comprises the following constituents :—

Indigenous Banks,

Indian Joint Stock Banks,

Imperial Bank of India,

Co-operative and Land Mortgage Banks,

Post Office Savings Banks,

Exchange Banks, and

The Reserve Bank of India.

Indigenous banking comprises bankers, money-lenders, shroffs, chetties, and nidhies engaged in a large variety of business in relation to agriculture, trade, and banking. Dr. L. C Jain has defined an indigenous banker as "any individual or private firm which in addition to making loans either receives deposits or deals in Hundies, or both," each of which functions clearly belongs to banking. They are a heterogeneous class performing different functions in different parts of the country and called by various names such as the Bania, the Sahukar, the Mahajan and the Shroff or the Chettiar. They also belong to various castes. There is a great *difference between a money-lender and an indigenous banker.* A money-lender lends his own money, does not receive deposits, advances money either for productive or unproductive purposes, finances mostly the needs of the cultivator for agricultural operations or consumption or litigation, and does not draw or accept Hundies. He usually combines agriculture, freight, and other occupations with money-lending. The most fundamental difference, however, is that a money-lender finances consumption rather than production, whereas an indigenous banker finances production rather than consumption. The indigenous banker deals with his own and borrowed money, receives deposits, finances trade and industry, confines only to banking business and deals in Hundies.

However, indigenous banks are *quite different from modern joint stock banks.* All indigenous bankers do not receive deposits, and even where they do, the deposits form a very small proportion of their resources; the modern banks raise funds mostly by deposits. The withdrawals of deposits from indigenous bankers are in the form of cash and not in cheques and therefore, they do not create deposit currency: a modern bank, on the other hand, allows withdrawals to be made by cheques, and thus creates deposit currency. Unlike the modern banks they do not confine themselves to banking alone but usually combine trade or industry or commission business with it. The indigenous bankers deal in stock exchange speculations in Bombay and Calcutta share and stock markets without any fear because they deal in their own money, whereas the modern bank scrupulously avoids speculative dealings. The indigenous bankers advance money on immovable property for long periods and conduct money-lending at high rates of interest but a modern bank does not do these things. Deposit business and discounting of bill is done by them to a very small extent unlike banks. Whatever the defects in their methods of business may be, the indigenous bankers render very important services in financing agriculture, small and cottage industries, and the internal trade. Even the much maligned money-lender, who lives on the needs of his neighbours, and usually trades into their necessities, is rapacious and charges exorbitant rates of interest, is an indispensable link in the rural economy of the country. He comes into very close personal touch with his clientele

and is the only financing agency available on the spot.

Nature of business : The methods of business of the indigenous bankers are very cheap and simple. There is no costly establishment or regular office as in the modern banks, and the accounts are very simple, accurate and efficient. The village money-lender is notorious for his capacity of living on rags. Similarly there is no system of elaborate formalities to be gone through before an account can be opened for a customer as in a modern bank, and hence delays in making advances are not to be found. There is no regular provision for banking education, the knowledge being picked up from old members. They come into close personal touch with small traders and industrialists, and are easily and always accessible. They maintain a complete secrecy with regard to their business and do not believe in advertising. They do not approach the outside market for deposits except the Nattukkottai chettiyars who are reputed to be the cleverest of all the indigenous bankers. In fact they are very shrewd and economical and sometimes carry on business in partnerships.

At present there are three kinds of these banks:

(*i*) those whose principal business is banking;

(*ii*) those whose main business is trading but they also do banking business with spare funds;

(*iii*) those who are both traders and bankers.

Functions of these banks : No reliable statistics

agents, brokers, jewellers, traders and industrialists. They carry on speculative dealings in stocks and shares, in wheat, cotton, jute and other raw products. They also draw, accept and discount hundies and thus provide remittance facilities to their customers. The village money-lender finances the credit needs of the cultivator on the security of land, cattle, ornaments, produce and personal security.

An approved list of indigenous bankers is kept by joint stock banks who assign to such bankers a certain amount of credit beyond which they do not discount their hundies except in special circumstances. During the busy season they approach the joint stock banks for accommodation, otherwise they carry on their business mostly with their own funds. The Imperial Bank also provides remittance facilities to them and grants accommodation by rediscounting hundies endorsed by them.

Defects of indigenous bankers: The business of these bankers hardly constitutes banking in the proper sense of the term They combine a large number of businesses. Their rates of interest are very high and the dealings of some of them, specially of the money-lenders, are often dishonest. The absence of deposit banking with them renders their funds inadequate. The financing of trade and industry is mostly done by cash credits and discounting of hundies does not occupy so large a proportion of granting accommodation. This leads to an absence of a native discount market. They also suffer from a lack of proper leadership. They are not adequately linked with general banking

system and confine themselves mostly to money-lending. They work independently of one another, and excepting a few important towns, they lack also in co-ordination. Recently they have formed associations in Bombay and Ahmedabad etc. They do not observe the sound principles of banking finance and do not publish their accounts to inspire public confidence.

Causes of their recent decline : Indigenous bankers have been in existence from Vedic times. In those early times they made loans generally to the poor and their rates were regulated. From fifth century B. C. they took to the business of money lending and of transfer of money in cash and credit instruments. Deposits were accepted and hundies discounted. Money-changing in those days of heterogeneity of money was a very profitable business. Internal trade was financed. The system was highly developed during the Moghul times. They helped kings and emperors in their campaigns, and there is an evidence of this in the fact that Emperor Furrukhsiar conferred the title of Jagat Seth on Fateh Chand of Murshidabad in recognition of his monetary help. During the days of the East India Co also they played a very important part in financing the internal and external trade of the country, and Lord Clive entertained the Jagat Seth at a cost of Rs. 17,373 for four days. Besides financing the trade of the country and financing kings and emperors in times of war on very high rates of interest and on personal security, they also acted as agents for collection of revenue from the cultivators, and on

account of their services to trade and industry and to the country acquired great power and influence. Some of them could compare with any private banking house in any other country of the world, and performed many functions of modern banks.

But with the establishment of the East India Co.'s rule, European merchants and English agency houses deprived them of foreign exchange business and of the financing of the foreign trade of the country; the unification of coinage in 1835 deprived them of their lucrative money-changing business; and the gradual establishment of joint stock commercial banks took away their banking business and financing of the internal trade. The Exchange banks monopolised the foreign trade financing, and the establishment of treasuries snatched away from them the collection of revenue. The coming in of the co-operative banks, post office savings banks and postal certificates has also taken away funds which formerly came to them. Then legal disabilities, high stamp duties, speculative dealings, and old and antiquated methods have militated against their usefulness.

Suggestions for improvement: With a view to restore their pristine glory, to create confidence in them among the public and to improve their methods the Central and Provincial Banking Enquiry Committees have made a number of suggestions and recommendations. The method of cash credit should be replaced by trade bills which will develop a bill market and establish a closer connection between the joint stock banks and the indige-

nous banks. They should change their methods of business to come in line with the modern banks, should publish their accounts and have them audited. They should either form big partnerships or get themselves registered as joint stock companies, should receive deposits, discount bills and issue cheques. In this way they will inculcate the habit of thrift and banking in the masses, discourage the hoarding habit and lend money at lower rates of interest.

For *linking* them up with the general banking system the various proposals of the committees are as follow :—

(i) They should be linked up with the R. B. by being appointed as agents in those places, where no other banking organisation exists, with restrictions on their speculative dealings to avoid risks.

(ii) They should be treated as member banks on the approved list of the R. B., subject to certain conditions, and on their depositing with the R. B. a certain fixed minimum, they should be given facilities for rediscounting like other member banks subject to certain conditions.

(iii) Commercial banks including the Imperial Bank should more freely discount their bills.

(iv) The same remittance facilities should be given to them by the Imperial and the Reserve Banks as they do to all other banks.

(v) They should reorganise themselves on modern lines to inspire public confidence, and the government should encourage reorganisation

by appointing such institutions, when formed, as government bankers.

(vi) A class of licensed bankers should be created with certain privileges and certain obligations.

(vii) They should form themselves into joint stock banks, or a co-operative bank of indigenous bankers should be formed to discount hundies of member banks, and it should have rediscounting facilities with the Reserve Bank.

(viii) An association of all-India banks and bankers should be formed, and approved indigenous bankers should be allowed to become its members; this will raise their status and improve their banking methods.

(ix) Bill-broking should be adopted as an integral part of the indigenous banker's business.

(x) "Kommandit" principles of banks of the German type, (a system by which in a joint stock organisation the shareholder charged with the management comes in with unlimited liability) should be established.

It is, however, a losing battle which the indigenous bankers are carrying against commercial banks which can raise any amount of deposits at cheap rates, can freely transfer funds from one centre to another, and are better organised to compete with them. These suggestions, when given effect to, at the most can give only a breathing time to a system which has already been killed in the Punjab and which is doomed in other provinces. One scans in vain the provisions of the Reserve Bank Act to find any effect given to

these recommendations. Mr. Manu Subedar in his Minority Report also suggested the registration of these banks, the granting of certain privileges and concessions, and the application of Rural Insolvency Act, Usurious Loans Act, and the enactment of the Regulation of Accounts Act like that of the Punjab in other provinces Still if the indigenous bankers carry out voluntarily the reforms suggested in these pages, and bring themselves in line with the modern banks in regard to audit and accounts, cheque and discounting of bills, and their methods of business, there, is no reason to doubt that they will continue to play a very prominent part in the rural and urban economy of the country, and in the financing of agriculture, trade and cottage industries.

Proposals of the Reserve Bank

In order to develop a systematised and centralised banking system, it is very essential that the indigerous banks should be brought into effective link and co operation with the commercial banks and the Reserve Bank of India, and we have seen above how the Central and Provincial Banking Committees made a number of important suggestions to achieve this object. The main responsibility of fulfilling this task was laid by the C. B Committee on the shoulders of the proposed Reserve Bank.

Under clause 55 (1) (a) the Reserve Bank was required within 3 years of the commencement of its business to report on the extension of credit facilities to the indigenous banks like the scheduled

banks and to make proposals for legislation for improvement in their methods of work.

The Reserve Bank of India therefore in its statutory reports and bulletins in 1937, while pointing out the difficulties of including the indigenous bankers in the organised banking system of the country, made proposals for legislation to co-ordinate the scheduled banks and the indigenous bankers. The main difficulties arise from the reluctance of these agencies to give up non-banking business and take to modern methods and practices of accounting and banking. The main points were :—

(1) That the indigenous bankers should become self-contained legal entities with at least Rs. 5 lacks of capital.

(2) For the purpose of control they should also maintain the same deposits with the R. B. as scheduled banks.

(3) They should segregate their banking operations from non-banking business and within a reasonable period, should follow only proper banking business as provided in the Indian Co.'s Act.

(4) They should maintain separate and properly audited books of accounts of their banking business and should submit to the Reserve Bank for determining their financial strength, like scheduled banks, periodical statements, of their audited accounts and should properly publish their accounts and B. S.

(5) They should discount their bills with scheduled banks which in turn will get them rediscounted with the R. B.

(6) Bankers with a capital of two lakhs, which might be raised within five years to five lakhs, would be entitled to register themselves in the books of the R. B. as private bankers, and, within this five year period they would not have to furnish compulsory minimum deposits, as in the case of the scheduled banks, until their time and demand liabilities were five times or more in excess of their capital in business. During five years from such registration, such banks will get rediscounting facilities like the scheduled banks.

(7) The R. B. would have the right to regulate their business on proper banking lines and to demand the names and interests of their business partners and co-sharers as in a joint Hindu family concern.

(8) The R. B. would propose a banking legislation to standardise, co-ordinate and regulate, before the end of 5 years, the business and status of these banks like the scheduled banks.

These proposals have been considered by the Indigenous Bankers' Associations in Bombay, Ahmedabad and elsewhere and there has been a very energetic protest and opposition to some of the proposals of the R. B. *e. g.*, deposits, publicity etc. The matter is still under negotiation and the R. B. should reconsider sympathetically the objections raised by them. Both sides in a spirit of

mutual accommodation and trust should agree to a well-balanced scheme of link and effective co-operation so that the indigenous banks should come within the orbit of the general banking system and play their proper role in the development of banking and credit facilities in the land. The Reserve Bank has been considering in the meantime the possibility of developing open market operations in trade bills to enable first class indigenous bankers to have relationship with the Bank without any material changes in their methods of operations The hundies in which these bankers specially deal are usually accommodation or finance bills and not trade bills, because documents of title are usually not attached to them. Moreover, the variety of rates, variations in usages and forms, restrictions on free negotiability on account of conditions imposed, and heavy stamp duties in *Muddati* hundies—these are other difficulties in getting them discounted and rediscounted. On 30th June 1941, the Reserve Bank placed 3 indigenous bankers on the approved list and grants them concession rates of remittances like non-scheduled banks on telegraphic and mail transfers as below :—

Up to Rs. 5000/- 1/16% (minimum Re. 1/-)
Over Rs. 5,000/- 1/32% (minimum Rs. 3/2/-)

Actual telegram charges are charged in addition.

The rates for the general public are 1/8% upto Rs. 5,000/- and 1/16% beyond that (minimum Rs. 6/4/-).

CHAPTER XI

INDIAN JOINT STOCK OR COMMERCIAL BANKS

Indian joint stock banks are those institutions which are registered under the Indian Companies Act and which receive reposits withdrawable by cheques and cater for the short-term credit needs of traders and businessmen, discount hundies and bills, and carry on other ordinary business of a modern joint stock bank Although commercial banking in our country is done by other banks also, like the Imperial Bank, the exchange banks, indigenous banks etc., we shall discuss in this chapter only the part played by the Indian joint stock banks in the banking and financial system of the country. These banks are denied the right to issue notes; they do not finance industries to any substantial extent, but provide only short-term credit to the traders and businessmen.

History of their growth : *With the decline of indigenous bankers the history of joint stock banking in India entered its first phase.* A number of *Agency houses*, which combined the business of attracting deposits and granting loans with trade and other businesses, were ship-owners, shopkeepers, proprietors of breweries, tanneries, distilleries, cotton, flour and saw mills. They also carried on agency business for the civil and military population of Europeans and for English merchants and bankers. Originally they had no capital of their own and depended on the savings of the servants of the East India Co. Most of the

members of these houses were ex-civil and military servants of the Company who took to mercantile business. They received accumulated funds belonging to them from the Company on their retirement and with the same started their business. They were in fact distributors of capital rather than the possessors of it and they made their profit by trade, by lending money and by commission. They raised deposits from the public and utilised them in financing the movement of crops, indigo, silk, opium and cotton business. The banking business of the Company was also entrusted to them in Calcutta and Bombay. As a result of their activities, Calcutta grew into prominence and the money market was therefore shifted from Murshidabad to Calcutta and in 1771 the treasury was also removed there. The usual rate of interest charged by them was 12%, but, by adding up several charges, it was raised to 18 to 20%. Some of these houses also issued paper money. They monopolised the foreign trade of the country and their position in this respect was strengthened by their command over shipping.

These houses were the forerunners of joint stock banks established on European lines. In 1813 when the monopoly of the East India Co. was abolished, these houses felt an acute competition from others and, in order to make up their losses in trade, they indulged in speculation in indigo, coal mines, ships, coffee and spice plantations, and in clearing desert lands, and working cotton, silk and flour mills. By 1825 their position became very precarious and they began to go to

the wall one after another. The immediate cause of their failure was the withdrawal of funds by their constituents. To meet their demands they began to borrow money by pledging property. But a more serious cause of their failure was the attitude of their correspondents in England who refused to honour bills drawn on them. This handicapped the agency houses in their banking business and as a result a number of them failed in the crisis of 1829-32. This was very undesirable for the depositors most of whom, specially widows and pensioners were ruined.

On the downfall of these agency houses organised banking institutions on western lines began to be developed. Probably it was in Madras that the Government started a bank in 1688. Then it was in Bombay in 1720 that another government bank was started, which was authorised to issue notes upto 8 lakhs of rupees in 1770, and it began to attract deposits by offering a rate of 5% on current account. Then came the Bank of Hindustan in 1770 which after weathering many a storm failed in 1832 with Messers. Alexander and Co. Then the Union Bank of Calcutta, the Agra Bank and the United Services Bank came into existence but like the first bank of Benares all of them failed. According to Cooke between 1770 and 1870 there were 39 banks started. Several attempts in the period were also made to start banks in London for conducting business in India, *e. g.*, the East India Bank, the Bank of Asia, the Bank of Australia and India, but most of them failed.

A *third* chapter in the history of joint stock

banking opened with the starting of the Presidency Bank of Bengal in the name of the Bank of Calcutta on June 2, 1806. The Government had undertaken to guarantee the responsibility of the Bank's establishment, and therefore it exercised control over its administration. The chief business of the Bank was to render service to the public, to help East India Co in its financial difficulty and to supply specie One-fifth of the capital of the Bank was subscribed by the Government of Bengal and it was granted a charter in 1809 and the power of note issue in 1823. Then the Bank of Bombay was started in 1840 with a capital of 50 lakhs of rupees, 3,00,000 of which were contributed by the Government of Bombay. The Bank of Madras was started in 1843 with a capital of 30 lakhs rupees, three lakhs were again contributed by the Government of Madras. All these Presidency Banks were entrusted with government funds and issued notes. In 1825 the P B. of Bengal was allowed to open branches and its capital was gradually increased. So that by 1838 it stood at $112\frac{1}{2}$ lakhs. It invested in government securities and lent on government securities. The Bank of Bombay was, however, involved in speculation during the American Civil War of 1861-66 and failed in 1868, but in the same year another Bank was established with a capital of one crore of rupees. These banks also financed internal trade, *but in 1862 the right of note issue was withdrawn from them by the Government. In 1876 the Government relinquished their shares in these banks and their right of*

appointing directors. Since then, these banks lost their official character, but they were governed by a special Charter Act of 1876 until their amalgamation into the Imperial Bank of India in 1921.

The year 1860 marked a land-mark in the history of joint stock banking in our country. In that year the principle of limited liability was first applied to banking concerns. Thereafter the development of joint stock banking was steady and regular; but the Government followed a policy of non-interference on account of which orthodox principles of banking were not insisted upon. The result was that a number of banks went into liquidation and shocked the public confidence in the honesty and sound methods of business of directors of the banks. The chief reason for a stimulus to development of banking after 1850, however, was *the boom in cotton trade* due to the American Civil War. Out of seven banks that were started during this period only three survived the boom and the consequent speculation in all sorts of business. This shook the public confidence in banking companies to such an extent that between 1870 and 1894 only seven more banks were started out of which only 4 survived. Later on in 1901 the People's Bank was founded. *Thus, before the end of the last century there was no conscious designing and planning in the banking development of the country.* The development of commercial banks was thus unsatisfactory and upto the end of the last century *only 9 banks with capital and reserves of 5 lakhs of rupees had been established and their total paid up capital and*

to 10,18 lakhs. This post-war boom in banking companies was accompanied with unsteady increase in the total resources of the banks. The inflation and depression of the war and post-war periods had their effect on the development of the banks. Bank failures continued and *during 1919-25 no less than 84 banks failed with a paid-up capital of 5,11 lakhs. Thereafter the number of A class banks increased from 28 in 1926 to 38 in 1935 and their capital and reserves from 10,84 lakhs to 13,20 lakhs; while the number of B class banks increased from 47 to 67 and capital and reserves from 1,26 lakhs to 1,50 lakhs in the same period. During the same period no less than 215 banks failed with a paid-up capital of nearly Rs. 1,78 lakhs representing about 9% of the total resources.*

Then the number of 'A' class banks increased from 38 in 1935 to 58 in 1940 and their capital and reserves from Rs. 13,20 lakhs to 14,66 lakhs; while the number of 'B' class banks increased from 62 to 122 and their capital and reserves from Rs. 1,39 lakhs to 2,44 lakhs. Besides there were 121 'C' class banks and 400 'D' class banks with 84 lakhs and 76 lakhs of capital and reserves respectively. During the same period, no less than 372 banking companies with a paid-up capital of Rs. 63,39,744 went into liquidation. A majority of these were small affairs with very small amounts of paid-up capital.

This history of the joint stock banks shows clearly that upto 1935 there was a rich harvest of bank failures in our country and this points out

to the fact that the development of commercial banking has not taken place on sound lines. The two main causes for this unsound and unstable state of affairs were the lack of suitable banking legislation regulating the bussiness of banking and the utter lack of a central bank co-ordinating currency and credit and acting as a friend, guide and philosopher to the commercial banks. Since the establishment of the Reserve Bank of India and the amendments to the Indian Companies Law in 1937 it has been expected that such bank failures would not recur in future. But the statistics of bank failures during 1935-'40 have belied this expectation. Still there is a need for a separate comprehensive banking legislation and the Central Banking Committee laid great emphasis on it and suggested the lines on which the legislation should proceed. The Reserve Bank of India in 1939 submitted its proposals for an Indian Bank Act in the form of a draft bill which the Government of India circulated for eliciting public opinion in January 1940. But uptill now probably on account of the war no further action in behalf of enacting suitable banking legislation and preventing heavy mortality among banking companies has been taken.

Operations of the Indian Joint Stock Banks: The chief operations of these banks consist of receiving deposits on current, fixed and savings bank accounts, and of lending out money on the deposit of easily marketable securities, granting clean advances on personal security backed by a two-signatures paper, and making short term

advances to traders, opening cash credits, and overdrafts and discounting bills and hundies. They finance the movement of produce from the villages to the mandies, and therefrom to the exporting centres and ports, and the movement of the imports from the port to the inland collecting and distributing centres. The financing of the movement of the produce from the mandies to the consuming centres is mostly done by purchase of demand drafts representing the produce despatched from approved customers; whereas, the financing of the movement of produce from the distributing centres to the exporting ports is done by purchasing drafts and telegraphic transfers drawn on port towns at low rates. They also advance against agricultural produce to approved commission agents and dealers at rates varying from 7 to 7½% based on the official bank rate and against gold ornaments. They finance agriculture further indirectly by cash credits and advances to co-operative banks. In this way they finance agriculture only indirectly. They usually confine their financial operations in agriculture to big landlords, planters etc. who can offer tangible and marketable securities. On a minimum monthly balance of 200 to 300 rupees they allow an interest of 4 to 5 per cent on fixed deposits and 2 to 2½ per cent on current deposits during the slack and busy season respectively, but since the depression of 1931 they have reduced the rates and now allow 1½ to 2 per cent on fixed deposits and ½ per cent on current accounts.

Clean advances against the personal credit of the borrower or on one-name paper, which is

the most popular and common practice in western countries, do not find much favour with these banks. This is due mostly to the excessive secrecy practised in India by traders and businessmen regarding their financial strength and status, and the general apathy against its revelation to the banks. They, however, make clean advances against two-names papers *i. e.*, personal security with a second signature to the promissory note. Such notes which are endorsed by shroffs or managing agents are preferred by them. The hundies which are in reality two-names papers with endorsements[1] of indigenous bankers are very extensively used. But the supply of two-names papers is very much limited as compared to the demand and the advances given by banks against such securities are very small. In bigger towns, where stock exchange securities are available, advances are made against their hypothecation; and in the countrysides, against the pledge of grain and raw materials of industry like cotton and sugar and for this purpose they maintain their own godowns or get possession of the godowns of the customers by taking the keys from them. They advance upto 75% of the produce hypothecated. Advances to traders are also made against their stock in trade as also to factories. Some of these banks also advance money on the security of landed property and other immovable goods but this is very seldom done.

The most common and popular method of making advances by the Indian joint stock banks is the granting of cash credits *i. e.*, against the

promissory note of the borrower backed by collaterals like shares, stocks, bonds; or goods, like cotton, jute, rice and other exportable produce. If the goods are left in the possession of the bank in its godowns, advances are made on deliveries of the produce, and deliveries are made on payment of the loans. The usual practice is to advance only upto 75% of the value of the produce, the balance is the margin for safeguard against fluctuations. This system is very popular with the Bombay mills. It affords many advantages to the borrower as well as to the banker. The borrower is required to pay interest only on the amount of the credit availed of by him, and he can reduce his obligation at any time subject to a minimum interest clause; and the banker can limit or withdraw the facilities at any time he likes. But this system of cash credit is very disadvantageous to the bank and the people in general, because it limits the development of bills and acceptance credit, and hence prevents the growth of rediscounting facilities.

In addition to making advances on cash credits, overdrafts and loans (secured and unsecured), they perform many agency services like payment and collection of coupons, cheques, dividends, subscriptions, rents insurance premia and collection and payment of promissory notes and bills; receive securities and valuables for safe custody, and serve as correspondents, representatives, trustees and executors, buy and sell securities for their customers, and obtain passports, travellers' tickets, and secure passages for them. Promotion of the

habit of thrift and banking and facilities for buying and selling securities are not provided by them to the same extent as in western countries. *They do not undertake trust business, foreign exchange business, the bank acceptance business and rediscounting business.* Similarly they *do not play any part in financing the trade from port to port either in export or import business, nor do they act to any great extent as referee to the financial standing of customers.* They also *do not*, unlike western banks, *play any part in underwriting loans of the central, provincial, or local governments.* Unlike the German and Japanese banks they *do not finance industries except occasionally* and that too to a very limited extent. They, however, issue letters of credit, circular notes, bank drafts, and travellers' cheques etc. for the benefit of the tourists and provide remittance facilities for transmitting money and capital from place to place.

Join Stock Banks and the Reserve Bank of India

For the successful operation of central banking functions and control and regulation of the volume of credit created by joint stock banks it is very essential that the Central Bank, being the sole supplier of currency and the lender of last resort, should have an effective control over the commercial banks; but it should not be allowed to compete with them in the ordinary business of banking. There was no effective link and control exercised by the Imperial Bank, although it performed some of the central banking functions

The following tables show the progress of A & B class banks :—

'A' Class Banks with Paid-up Capital and Reserves of 5 Lakhs of rupees and over :—

(In Thousands of Rupees)

Year	No. of Banks	Paid up Capital	Rest and Reserves	Total Paid up Cap and Res	Deposits	Cash Balances
1870	2	9,83	1,82	11,95	13,95	5,07
1880	3	18,00	3,11	21,11	63 37	16,63
1890	5	33,60	17,59	51,09	2,70,78	55,79
1900	9	82,12	45,60	1,27,72	8,07,62	1,19,01
1905	9	84,57	77,82	1,62,39	11,98,92	1,73,50
1910	16	2,75,66	1,00 55	3,76,21	21,65,35	2,80,25
1913	18	2,31,33	1,32 94	3,64,27	22,59,19	4,00,17
1916	20	...	...	4,61,02	21,71,05	6,03,49
1917	18	..	...	7,63,94	58,99,47	12,16,63
1920	25	8,37,02	2,55,46	10,92,48	71,14,64	16,80,70

Continued

Year	No. of Banks	Paid-up Capital	Rest and Reserves	Total Paid-up Cap and Res	Deposits	Cash Balances
1921	27	...	...	12,39,61	76,89 63	15,65,90
1922	27	...	...	10,63,89	61,63,86	12,03,38
1923	26	...	.	9,73,44	44,42,82	7,37,01
1924	29	...	...	10,70,94	52,50,52	11,29,70
1925	28	...	...	10,59,64	54,49,36	10,09,55
1926	28	...	...	10,84,39	59,68,02	9,11,64
1927	29	...	...	11,08,05	60,84,11	7,69,86
1928	28	6,74,84	4,34,66	11,09,50	62,85,36	8,19,00
1929	33	7,86,97	3,66,54	11,53,51	62,72,03	9,04,99
1930	31	7,47,31	4 42,81	11,90,15	63,25,51	7,67,91
1931	34	7,80,30	4,28,14	12,08,44	62,26,44	7,71,03
1932	34	7,81,81	4,30,33	12,21,14	72,34,00	9,75,76
1933	34	7,78,24	4,55,28	12,33,52	71,67,43	10,91,64
1934	36	7,99,49	4,67,74	12,67,23	76 77,26	11,14,26
1935	38	8,17,49	5,02,36	13,19,85	84,44,01	19,12,15

Continued

Class. 'A'—Banks with Paid-up Capital and Reserves of Rs. 5 lakhs and over:

(In Thousands of Rupees)

Year	No of Banks	Paid-up capital	Reserves	Total of paid-up capital and Reserves	Deposits	Cash Balances	Bills discounted, Loans and Advances	Investments in securities
1936	42	8,48,82	5,46,51	13,95,33	98 14,20	16,28,37	52,08,33	38,12,20
1937	39	7,25,17	5,53,09	12,78 26	1,00,26,50	16,81,60	55,06,91	37,60,54
1938	43	7,48,91	5,65,51	13,14,42	98,08,27	14 00,29	52,20,96	41,70,80
1939	'A'1 39	7,24,59	4,69,04	11,93,63	93,74,12	16,11,89	52,58,34	36,50,53
	'A'2 12	1,00,99	61,62	1,62,61	6,99,07	60,23	5,28,01	2,44,45
	51	8,25,58	5,30,66	13,56,24	1,00 73 49	16,72,12	57,86,35	38,94,98
1940	'A'1 41	7,77,65	4,89,43	12 67,08	1,06,10,08	25,02,43	48,54,64	42,44,86
	'A'2 17	1,31,30	67,24	1,98,54	7,88,37	1,23,76	5,49,24	2,74,97
	58	9,08,95	5,56,67	14,65,62	1,13,98,45	26,26,19	54,43,88	45,19,83

Note :—'A'1 = Scheduled Banks ; 'A'2 = Non-scheduled Banks.

'B' Class Banks with Paid-up Capital & Reserves between 1 lakh and 5 lakhs
(In Thousands of Rupees)

Year	No of Banks	Paid-up Capital and Reserves	Deposits	Cash Balances
1913	23	60,49	1,51,15	24,95
1916	28	63,27	1,01,23	16,76
1919	29	74,07	2,28,49	53,71
1920	33	81,37	2,33,46	41,91
1921	38	1,00,28	3,26 02	43,52
1922	41	1 10,65	3,37,81	56,02
1923	43	1,11,31	3 26 50	61,47
1924	41	1,07,99	2,69,06	35,14
1925	46	1 18 49	3,41,40	67,89
1926	47	1,25,94	3,46,97	82,14
1927	48	1,22 20	3,45,68	52,23
1928	46	1,19 87	3,49,66	52,09
1929	45	1,15,02	3 57,61	44 95
1930	57	1,10,85	4 39,18	52,19
1931	54	1,27,72	3,92,16	47,27
1932	52	1,29,35	3,92,64	67,60
1933	55	1,30,71	4,74,84	81,86
1934	99	1,48,83	5,11,12	71 51
1935	62	1,38,74	5,27,67	82,15
..				

There were 1235 banking offices including branches and agencies of all kinds in 1935.

Class 'B'—Banks with paid-up Capital & Reserves between Rs. 1 lakh and Rs. 5 lakhs.
(In thousands of Rupees).

Year	No of Banks	Paid-up capital	Reserves	Total Paid-up capital & Reserves	Deposits	Cash Balances	Bills discounted, Loans and Advances	Investments in securities
1936	71	94,06	52 72	1,46,78	5,46,41	99,54	4,74,28	58,08
1937	108	1,44,15	72,55	2,16,70	8,28,89	1,32,78	7,45,82	1,03,39
1938	120	1,62,48	78,70	2,41,18	8,72,42	1,28,90	7,73,61	1,33,53
1939	119	1,57,66	74,81	2,32,47	9,27,26	1,37,39	8 85,26	2,14,10
1940	122	1,67,42	76,44	2,43,86	11,03,96	2,24,47	8,14,05	2,08,31
Class 'C' Banks with paid-up Capital & Reserves between Rs 50,000 and Rs. 1 lakh.								
1939	112	60,96	16,19	77,15	2,98,17	51,98	2,64,74	42,09
1940	121	65,42	18,54	83,96	2,85,82	58,72	2,58,69	43,62
Class 'D' Banks with paid up Capital & Reserves of less than Rs. 50,000								
1939	400	61,52	14,27	75,79	2,63,23	38,03	2,86,06	22,62

There were 2059 banking offices including branches and agencies in 1940.

like running the clearing houses, declaring the bank rate and discounting bills of exchange etc., and the banks were not required by law to maintain any balances with it. But now the Reserve Bank of India exercises some control over these banks through its bank rate and open market operations, and by requiring banks which have a capital and Reserve of Rs. 5 lakhs to deposit 5% and 2% of their current and fixed deposits with the Reserve Bank in lieu of which these banks are granted certain remittance facilities together with the rediscounting of their genuine commercial papers with it. Secs. 17,18 and 19 of the Reserve Bank of India Act 1934 lay down certain functions which affect profoundly the joint stock banks. Sec. 17 lays down that the Bank shall (*a*) accept money on deposit from banks (*b*) purchase, sell or rediscount eligible bills of exchange and promissory notes bearing two or more good signatures, one of wihch must be that of a 'scheduled bank'* (i.e. bank with a capital and Reserve of Rs. 5 lakhs and over which is a company as defined in clause (2) of Sec. 2 of the Indian Companies Act, or a corporation or company incorporated by law in any place outside British India and included in the second schedule to the Reserve Bank Act, and depositing 5% and 2% of its demand and time liabilities) (*c*) purchace from, and sell to, the scheduled banks sterling and eligible bills of exchange

**There were 59 scheduled banks working in British India including the Imperial Bank and 17 Exchange banks at the end of 1940.*

including treasury bills of U. K. (*d*) make loans and advances to the scheduled banks repayable on demand or on expiry of fixed periods not exceeding 90 days against trustee securities, gold or silver or documents of title thereof, bills and promissory notes eligible for purchase or rediscount; promissory notes of a scheduled bank supported by documents of title to goods transferred, assigned or pledged to any such bank as security for *bona fide* cash credit or overdrafts (*e*) issue demand drafts made payable at its own offices or agencies and make, issue and circulate bank post bills (*f*) borrow money from a scheduled bank in India for a period not exceeding one month, provided the amount so borrowed does not exceed the share capital of the bank. Sec. 18 authorises the Bank to carry out open market operations: deal directly with any person when it is found expedient to regulate credit in the interests of Indian trade, industry and agriculture. On the other hand, Sec 19 prevents the Bank, with a view to avoid competition with the scheduled banks, from accepting deposits on interest, from ordinarily granting loans directly to the public and from purchasing commercial paper without the signature of a Scheduled Bank or a Provincial Co-operative Bank. Thus Secs. 17 and 18 influence very powerfully the volume of credit transactions of the joint stock banks. The Bank provides temporary financial accommodation in the form of rediscounting eligible bills and loans and advances against eligible securities to these institutions whereby they increase their liquid resources, their lending power, and get help in

periods of stringency or emergency against suitable security and on satisfying the Reserve Bank about their soundness and stability. Moreover, this activity of the Bank increases the elasticity of credit and deposit currency and relieves monetary stringency. The Bank also granted free remittance facilities to the scheduled banks for transfer of Rs. 10,000 and over upto Sep. 1940; the Imperial Bank used to charge $\frac{1}{2}$ anna % for tranfers of Rs. 10,000 and over between their branches and even this was considered to be a high rate by the C. B. I. Committee The banks were prejudiced against rediscounting of bills with the Imperial Bank of India.

From 1st Oct. 1940 the Reserve Bank has introduced its new scheme of remittance facilities under which a scheduled bank is entitled to remit money by mail or telegraphic transfers between the accounts kept by its offices, branches, sub-offices and pay offices at an office, branch or agency of the Reserve Bank in British India and Burma as follows :—

1 (a) An amount of Rs. 10,000 or a multiple thereof, between its accounts at the offices and branches of the Reserve Bank, free of charge;

(b) Once a week an amount of Rs. 5,000 or a multiple thereof, to the principal account which it maintains with the Reserve Bank from any place at which it has an office, branch, sub-office or pay office, and at which there is an agency of the Reserve Bank, free of charge ;

(c) Other remittances to its principal account subject to a charge of 1/64% and also subject to a minimum charge of Re. 1 ; and

(d) Other remittances between accounts maintained at the Reserve Bank or its agencies;

Upto Rs. 5 000	...	1/16% (minimum Re. 1/-)
Rs. 5,000 and over	...	1/32% (minimum Rs. 3/2/-)

2. Telegraphic transfers and bank drafts in favour of third parties are also issued, subject to the limits on drawings on treasury agencies, at the following rates:

Up to Rs. 5,000	...	1/16% (minimum Re. 1/-)
Over Rs. 5,000	...	1/32% (minimum Rs. 3/2/-)

Actual telegram charges are charged in addition.

Then there are the non-scheduled banks—a heterogeneous class comprising (a) banks with a capital and reserve of Rs. 5 lakhs or over which are not included in the schedule including some Indian State banks without any branch in British India ; (b) banks with capital and reserves between Rs. 1 lakh and Rs. 5 lakhs, (c) banks with capital and reserves between Rs. 50,000 and Rs. 1 lakh and (d) banks with capital and reserves of less than Rs. 50,000. At the end of 1940 there were 17 banks of (a) category ; 122 banks of (b) category, 121 banks of (c) category and 680 banks of (d) category out of which only 400 banks

submitted returns under sec. 277 L of the Indian Companies Act 1936. Out of 604 non-scheduled banks operating in British India on 31st December 1940 and submitting cash reserve returns as many as 347 had capital and reserves of less than Rs. 50,000. All these vital links in our banking system lie outside the purview of the Reserve Bank, but it keeps in touch with them and gives them advice when requested for it. At the instance of the Bank the Central Government amended the Indian Companies Act in Feb. 1938 to provide for the submission of 3 copies each of their statutory returns by the banking companies to the Registrars of Joint Stock Companies. Since then the Bank has been receiving a copy each of the cash reserve returns and balance sheets filed by banking companies under Sec. 277 L and 134 of the Indian Companies Act. A very interesting memorandum on non-scheduled banks, their assets and liabilities etc. based on these statutory returns was published by the Bank along with its proposals for an Indian Bank Act In its two circular letters dated 19th Nov. 1938 and 14th Aug. 1939, the Bank indicated the manner of giving its advice and guidance to these banks. Some of them have availed themselves of this offer. Special remittance facilities at concessional rates are also granted by the Bank to such non-scheduled banks as are on the approved list of the Reserve Bank prepared in consultation with the Provincial Govts. In its circular letter dated 23rd Oct. 1940, non-scheduled banks have been required to fulfil the following conditions before they can avail themselves of the concessional rates :—

(*i*) that they are companies registered under the Indian Companies Act,

(*ii*) that they are carrying on banking business in British India according to the provisions of the said Act,

(*iii*) that they have a paid up capital and reserves of Rs. 50,000.

On 30th June 1941 there were 37 approved non-scheduled banks and *three* indigenous bankers who were eligible for concession rates of remittances as below :—

Up to Rs. 5,000 1/16% (minimum Re. 1/-)

Over Rs. 5,000 1/32% (minimum Rs. 3/2/-)

Actual telegram charges are to be paid in addition.

As to *control* exercised by the Reserve Bank over the scheduled banks, in addition to maintaining a balance of not less than 5% of its demand and 2% of its time liabilities with the Reserve Bank, every scheduled bank has to submit to the Reserve Bank and the Central Government a weekly return of its position in the form prescribed by sec. 42(2) or a monthly return in case of geographical difficulty, to enable the Bank to prepare and publish a consolidated statement as required by sec. 43 of its Act. This statement furnishes an index to the prevailing money conditions in the country. If a scheduled bank fails to maintain the requisite minimum balance, the Reserve Bank is empowered to impose a penal interest on such a defaulter on the deficit balance at the rates prescribed in sec. 42(3) (5% higher than

maximum bank rate). The Reserve Bank of India (Third Amendment) Act 1940 has now empowered the Bank to prohibit defaulting banks form accepting fresh deposits during the continuance of the default and to fine directors and other officers who are knowingly and wilfully parties to it. On the other hand, if a scheduled bank fails to submit the weekly or the monthly return it is liable to pay to the Central Government or to the Bank, or to each, a penalty of Rs. 100 for each day during which the failure continues.

The Reserve Bank of India has thus been given the powers usually conferred upon central banks and through the variation of its bank rate and open market operations it is expected to exercise an effective control over the banking system. Other methods which to some extent can help the Bank to control the money market and banking conditions are suitable changes in the amount of treasury bills offered, in the amount of sterling purchased and in the quantity of money in circulaion. They are, however, not so effective nor so widely applicable as the bank rate and open market operations are. But "the bank-rate acts on the willingness of scheduled banks to borrow from the Reserve Bank; open market operations, act on the willingness of banks to lend to their customers."[1] The scheduled banks usually do not borrow large sums from the Reserve Bank and approach it only in exceptional times. The vast majority of the small banks have no access to it and borrow therefore mostly from bigger banks.

K. S. Muranjan: 'Modern Banking in India', p. 268

The Reserve Bank is therefore only indirectly concerned with them and must share with the bigger joint stock banks its control over the entire banking system. Even on the scheduled banks the Bank can exercise greater control only when they approach it for financial assistance and are prepared to submit their accounts voluntarily for inspection. But as the inauguration of the Reserve Bank has coincided with an unprecedented era of plenty of money and easy rates, loans and advances to, and discounts for, scheduled banks have been very meagre. The actual control of the Bank therefore is very much limited by the peculiar monetary and banking system of the country The orthodox methods of central banking control are much less effective here than in western countries. "The diversity, of interest-rates in several parts of the country, the absence of a money market which may respond quickly and sensibly to central bank policies, the vast territorial extent of the country over which monetary impulses released from a few advanced centres have to travel, a banking structure in which numerous small banks scattered all over the country must remain for a long time outside the orbit of the Reserve Bank—these are obstacles which a central bank acting through a few scheduled banks may not succeed in overmastering."* A just and real test of effectiveness of its policy and control will come only in a period of monetary stringency.

Scope for their expansion and development

A perusal of the statistics relating to the

* *S. K. Muranjan : op. cit. p. 276.*

growth and development of joint stock banks in India, and a comparison of the vast dimensions and enormous population of the country with the number of banking offices extant, show very clearly that there is still a large scope for their expansion and specially for the development of branches of the existing banks Out of 2500 towns in the country, hardly 400 in 1930 had a bank or a branch of a bank. In 1930 there were in all 882 offices in the whole of India which worked out at 2.5 bank offices per million of the population as compared with 417 offices per million of population in Canada, 273 in United Kingdom, 179 in the United States, 103 in Japan, 49 in France and 33 in Germany. In 1934 out of 2500 towns only 480 had a bank or a branch and the total number of bank offices was 1269 as compared to 25000 in U. S. A., 13200 in Great Britain, 4,500 in France, 3,400 in Germany, and 1,300 in Belgium, giving one office for every 276,000 persons in India as against 3056, 4816 and 9491 in the U. S. A., G. Britain and Japan. In our villages where 90% of our people live, there is still hardly any banking facility available and this makes the inadequacy of banks still more glaring. Although there has been a growing tendency towards increasing the branches in recent years (the number of banking offices increasd from 1092 in 1931 to 1269 in 1934, comprising 323 head offices including those of the Imperial Bank, and 946 branches including those of the Imperial Bank and the exchange banks; and according to Mr. J. B. Taylor, the number of the pay-offices and branches of the Scheduled

banks alone increased from 723 in 1936 to 1,138 in 1938), "it is obvious that much further progress in this direction will be necessary before India can have a net-work of joint stock banks adequately covering the country."

The absence of banking aud credit facilities choke up the small surplus available from people for the development of credit facilities to the detriment of trade and industry. Inspite of the fact that apart from ornaments, the hoarded wealth with the people is very small, there are reasons to believe that there is a large potential capital, which, through the lack of adequate and proper banking facilities providing opportunities for investment, lies inert in idle hoards, and if shyness and timidity of the Indian capital is to be removed, there must be facilities of banking provided to draw it out of the unproductive hoards. The evidence of this potential capital is furnished by the increase in the volume of deposits of all banks during the first two decades of this century and successful flotations of a large number of joint stock enterprises of all sorts in industry, banking; mining, insurance etc., in the increased deposits of the co-operative and post office savings banks and the volume of postal cash certificates and the successful short-term borrowings of the government in the form of treasury bills and short loans. True it is that in the third decade of the century on account of depression and the setback caused by many bank failures the deposits of these banks remained stationary, but now there are clear signs of increase visible once more. The same fact is proved

by the recent export of substantial amount of capital to foreign countries even during the present war and substantial increases in deposits of all kinds of banks.

Inspite of such a vast field for its expansion and growth the development of joint stock banking in our country has not been active and rapid, nor is it even and commensurate with the need of the country. In 1934 there were only 1269 banking offices of all the banks including the Imperial and Exchange banks scattered over an area of 1.9 m. sq. miles and catering for a population of 353 millions.* Their geographical distribution was as follows:

Assam	10	Delhi	26	Travancore	74
Baroda	18	Hyderabad	13	U. P.	124
Bengal	122	Kashmir	15	Other States	35
Bihar & Orissa	38	Madras	305		
		Mysore	45		
Bombay	98	N. W. F. P.	38		
Burma	60	Punjab	163		
Cochin	15	Sind	25		
C. P.	25				

Causes of the slow growth of Joint Stock Banking in India: The development of joint stock banking in India therefore has been very slow and backward. It has not at all been commensurate with the size of the country and its enormous population. There are various towns without a

In 1940 there were in all 2059 bank offices excluding cooperative banks catering for a population of about 40 crores

bank and the rural areas are altogether devoid of banking facilities. If we compare India with United Kingdom in this respect the backwardness of banking development becomes very clear. In U. K. there is a branch of a bank for every 3,500 people and in England and Wales for every 4,500 people India is 15 times greater in area and has nearly 8 times larger population than U. K. This brings out clearly the paucity of banks in our country and the wide scope for their development. The main causes responsible for the slow development of banking in India are the following.

(i) *Hoarding habit* and direct loans to trade and industry in the form of deposit with firms and companies: This is not so much a cause preventing the growth of banking as a result of lack of banking facility in the rural areas. The deposits kept by people with persons have been very little, activities of banking show the dearth of banking and the dearth of suitable investments understood by people in which money may be invested; but this is a phase of transition through which India is passing.

(ii) *Bank failures and their deterrent effects*: On account of numerous bank failures (765 between 1913 and 1940) in the country people show a great apprehension with regard to the safety of their funds deposited in banks. They place their funds direct with merchants and industrialists. Unfamiliarity with the joint-stock enterprise is responsible for this bank mortality to a great extent. Bank failures lead to a loss of confidence of the public in the

stability and integrity of the banks and their directors and so discourage investment in bank shares. Enterprisers are also scared and discouraged to launch on new schemes of banking development.

(iii) *The attitude of the government and public authority* : Indian efforts in the field of banking have seldom been viewed with enthusiasm and have been generally regarded with suspicion in official circles. The history of Indian banking and insurance abounds in instances of this kind. They have received little encouragement and sympathy from Government and semi-government bodies and institutions.

(iv) *Competition and opposition of foreign institutions* : The most advantageous and profitable businesses have been monopolised by the foreign exchange banks who have taken undue advantage of an open door and free trade policy of the Government of India, and have not allowed the growth of the Indian owned, Indian manned and Indian managed concerns. With their greater resources they have been more than able to underbid the Indian banks in attracting deposits.

(v) *Limited trade and business in Indian hands* : Banks prefer trade and industry should prosper but when the profits of trade and industry in Indian hands fall, the prosperity of Indian banks suffers. A very large portion of our trade being in the hands of foreigners, they naturally prefer their own kith and kin to Indians in matter of business and banking relations.

(*vi*) *Lack of preference to Indian banking*: National sentiment plays a very important part in business and as most of the banks in India are managed by Europeans they usually favour foreign shipping and insurance companies and these in turn favour them. But Indian agents and firms who are subordinate to these foreign houses do not favour Indian institutions. The absence of such sentiment, unlike other countries, is undoubtedly a great handicap to Indian institutions.

(*vii*) *Ban against entry into the Clearing House System*: Before the establishment of the Reserve Bank, Indian joint stock banks were not allowed to enter the clearing houses because the membership depends upon voting of the member banks, and, as most of these are foreign institutions, they raise difficulties and oppose the entry of new Indian banks, and specially the smaller ones. There is reason to believe, as Mr. Manu Subedar has pointed out in his Minority Report, that Indian institutions generally, and Indian joint stock banks in particular, are disparaged by the superior staff of foreign institutions There are a large number of brokers, middlemen and others including actual and prospective borrowers and bank clients through whom ridicule, disparagement, and discouragement against Indian banks in general, and new Indian institutions in particular, are transmitted to Indian public.

(*viii*) *Dearth of Capital*: One of the chief

characteristics of the Indian money market is the paucity of loanable funds which limits the banking expansion. The chronic and hopeless poverty and indebtedness of the masses hardly leaves any surplus for investment. And people who have money to invest usually prefer investments in landed property, government securities and trade, to investments in bank shares. The government itself has borrowed directly from the people in the past and this practice has militated against bank deposits, because the security of the government is much better than that of a commercial bank. The lack of investment habit and the limited quantity of loanable capital prevent banks from getting sufficient deposits, and, therefore, they are unable to work to their utmost capacity.

(ix) *Absence of cheque habit and cash dealings*: People, being ignorant and illiterate, are not familiar with cheques and other instruments of credit which restrict the operations of established banks and the scope for new ones. The Indian joint stock banks are cheap but ineffectual imitations of European banks and have not shown originality or initiative in developing on new lines. Cheque and other instruments are written in English and all work is conducted by banks in English and not local vernacular which militates against their familiarity. Hindi has been in use since long and the cheque habit can develop very easily if cheques are written in vernacular and the people understand the elementary principles of banking. It is a happy

augury that some banks have begun to issue Hindi cheque books. But more should do so.

(x) *Legal hindrances*: There is not definite banking law in India and the banks are usually regulated by the Indian Companies Act which is not suitable for banking concerns. Recently the Act has been amended, still it leaves much to be desired A number of legal and customary hindrances to the development of credit and its expansion are caused by the laws of inheritance and customs relating to succession and transfer of rights and by the Land Alienation and Transfer of Property Acts.

(xi) *Absence of branch banking*: Banks are usually confined to industrial and commercial towns and the countryside still remains untapped. Branch banking, which is so characteristic of the English banking system in the post-war period, is conspicuous by its absence here. In India there is one branch for every 1775 sq. miles and for 3,29,598 heads of the population. There is nothing here approaching the English branch banking system. It is very economical to operate and easy to control in times of national emergency. Then the majority of people here are poor and have very low income, whereas the limit below which no bank will open an account for customers has been usually fixed at Rs. 200.

(xii) *European Management of banks*: As most of the banks are managed by Europeans, who have no knowledge of the methods of business carried on by Indian businessmen, so they are naturally prejudiced against the latter.

(*xiii*) *Lack of an efficient and well trained staff :* The management of banks in India is not so uptodate and methodical. Wealth and status rather than expert technical knowledge is the criterion for the selection of bank directors and managers. On account of a lack of a Bankers' Association on an all India basis, the system of banking education is extremely defective. The government attitude so far towards technical, commercial education has been one of apathy. The lack of a suitably trained clerical staff is one of the main reasons for the absence of branch banking development.

(*xiv*) *Lack of an organised bill market and a clearing house system* : Banks deal in the purchase, sale, and discount of bills of exchange and promissory notes and thus by supplying credit relieve monetary stringency in the money market. There is uptill now an utter lack of a well-organised bill market here. The Reserve Bank of India, as expected, has not been able to develop one so far. The existence of the clearing house system dispenses with the necessity of keeping large cash reserves and facilitates the mutual redemption of debts of banks *inter se.* It therefore reduces the cost of rendering services by commercial banks and popularises the use of deposit currency. On account of a lack of both of these institutions, the banks in India are not able to render services efficiently. Absence of bank acceptances and trade bills lead to investment of funds in Government securities and hamper in this way the expansion of credit.

(*xv*) *Lack of an organised money market in the rural areas*: Money-lending is a very profitable business in the *mofussil* and the high rates of interest earned prevent people from investing their funds in bank deposits. The lack of thrift and banking and of adequate means of communication and transport prevent the forces of demand and supply to play their part in the villages The money-lender is supreme there. There is no agency or mechanism to mobilise the surplus funds from the villages, and the cultivators usually practise subsistence farming and are illiterate, and there are no proper storage facilities or warehouses or godowns, there is an utter lack of agricultural bills. And the *lack of co-operation and co-ordination between the various credit agencies in the money market and between the rural and the urban agencies is a stumbling block in the development of banking in the rural areas teeming with millions.*

(*xvi*) The unfair competition of the Imperial Bank of India, enjoying a privileged position and handling freely government balances have also to some extent been responsible for the backwardness of the banks. "On the one hand, they are looked upon as dangerous rivals by the indigenous bankers, and on the other, they frequently find themselve in opposition to the old established exchange banks and the powerful Imperial Bank of India. Placed in this position, therefore, they have been called the Cinderellae of the Indian banking system, and

have only been able to exist amidst bickerings, suspicions, and cut-throat competition." They have all been prejudiced against rediscounting of bills with the Imperial Bank.

Finally, these banks have suffered from mutual jealousies, lack a *esprit de corps.* They have not co-operated and presented a united front to their competitors.

Suggestions for improvement

The brief study of the growth, organisation and functions etc. of the Indian joint stock banks brings out clearly that there are several very weak spots in the present system and that a greater control of banks either by legislation or by inspection is necessary To provide for further expansion of these banks for which there is ample scope it is imperative that the serious defects and obstacles in their way must be removed at the earliest possible date. The main difficulties are the lack of proper encouragement from Government and semi-Government public bodies, unfair competition of Exchange Banks and Imperial Bank; deterrent effects of bank failures, Hindu and Mohammedan Laws of Inheritance and Transfer of Property Act and the lack of *esprit de corps* among the banks. Unless these difficulties and defects are successfully tackled and solved, the commercial banks cannot progress rapidly.

With this end in view the Government should chalk out a programme of banking development and lay down a progressive banking policy *by abandoning the present laissez faire policy.* It

appears that the Government have recently given up their traditional attitude of non-concern and detachment. But it is suggested that *the Government should pass a comprehensive Bank Act to regular the organisation and business of these banks.* Smaller banks should be exempted from stamp duties and registration fees like co-operative banks and in case of amalgamation they should be exempted from super-tax, stamp duties and other taxation for a limited period. The Hindu and Mohammedan Laws of Inheritance should be suitably amended and the Transfer of Property Act relating to the equitable mortgages should be applicable to a number of important commercial centres Similarly competition should be regulated by suitable measures and the Government should carry out its credit operations in such a way as not to affect the business of banks adversely as to the price of credit and depreciation of reserves. But above all the joint stock banks should have a *esprit de corps.* They should form themselves into associations to consider matters of mutual interest and co-operation for improving their methods and the general standard of banking or to remove elements of weakness or to promote the amalgamation of small with large banks. In order to enhance their influence and power they should be united and form an All India Bankers' Association.

Other reforms suggested for the improvement of the working of these banks are :—

1. *Development of branch banking*—It is a notable tendency in all western countries and should be

encouraged here. All banks should develop branches in the mofussil and should set up a net work of branches and offices to connect the various parts of the country so that a national money market may be created. The Central Banking Committee suggested that branches should be opened under a licence from the Reserve Bank which should issue licences freely. It was also suggested that the Bank should place, for the first five years with every new branch opened at a place where there is no banking office, a deposit but this was not provided in the R. B. Act 1934. The other two facilities of remittance and rediscount suggested by the Committee are provided by the Bank. If new branches are not profitable owing to inadequate bussiness then sub-branches and pay-offices for two or three days in a weak should be opened. Indeed on account of peculiar circumstances in India small local banks are a desideratum. Instead of establishing new banks new branches should be established by all banks. Branch banking is very economical and advantageous from several points of view. The difficulties in the way of branch development in banking should be removed.

2. *Amalgamation of the small units* into bigger ones: There has been a great tendency towards amalgamation in western countries in the post-war period. It would lead to economy and efficiency in working.
3. *Economy and efficiency by linking up with indigenous bankers.*

4. *Elasticity of credit by developing the cheque* habit and *organising clearing houses* in all important commercial centres. The cheques and other instruments and books should be written in vernacular scripts and withdrawals from post offices should be allowed by cheque.

5. *Mechanisation* i. e. use of machinary for routine work like addition, subtraction etc.

6. *Banking education* both theoretical and practical should be encouraged and developed.

7. Indigenous bankers and their sons should be given preference in matters of appointment on the staff of the banks. And only well-trained and qualified men should be appointed Shareholders' Associations should be formed to encourage the shareholders to take more lively interest in the affairs of the banks and a systematic propagada should be carried on to enlist public sympathy.

8. Institutions like the 'Syeds' and 'Duns' of America and England, to establish the necessary contact between the borrowers and the lenders by supplying confidential and reliable information regarding financial stability, character, and business-like dealings of the would-be customers of the banks, should be developed and the practice of 'one man, one bank' should be followed for clean advances.

9. Home safe accounts to develop the habit of thrift and banking among the masses should be instituted.

10. The development of specialised banks like the

land mortgage banks and industrial banks to serve the special needs of agriculture and industry should take place.

11. The co-ordination of the services of all the credit agencies by the Reserve Bank should be effected.

12. Regulation of money-lending and the discouragement of the hoarding habit should be provided.

To make the masses credit-worthy, there should be a systematic development of scientific agriculture, marketing facilities and co-operation and compulsory primary education to enable them to appreciate the advantages of banking and investment. Genuine and regular trade and agricultural bills should be developed. And the banks should make advances to cultivators against ornaments, standing crops and produce, should discount agricultural papers more liberally, should invest to a limited extent in the debentures of the land mortgage banks guaranteed by the Government, and should strengthen the existing provision for overdraft on the backing of approved promissory notes of central co-operative banks and primary societies. Central co-operative banks should also be allowed to carry on ordinary commercial banking within safe limits. This will go a long way in expanding the banking facilities into the interior of the country.

CHAPTER XII

IMPERIAL BANK OF INDIA

The Imperial Bank of India, which occupies a unique status in our banking system, came into existence on the amalgamation of the three Presidency Banks of Bengal, Bombay and Madras and began to function from the 27th of January 1921. The necessity for a central bank for India to co-ordinate the services of the various credit agencies, to remove the inelasticity of currency and monetary stringency during the busy season by developing a co-ordinated policy of currency and credit had been felt at a very early stage of the development of joint stock banking, but on account of the apathy of the Government of India, the provincial and personal jealousies of vested interests, the vast extent of the country and the difficulty of securing the adequate number of capable directors within the country, the problem could not be solved. In his memorandum appended to the report of the Chamberlain Commission in 1913-14 Mr. J. M. Keynes advocated very strongly the establishment of a state-aided central bank, but before the report could be considered and effect could be given to the various suggestions for improvement, the Great War broke out. The war, however, served a very useful purpose, and it was, that it brought home to the Government and the people the inherent weakness of the banking system and emphasised the necessity of opening a central bank of issue at

the earliest possible date. The Babington Smith Committee reporting in 1919 also hinted at the establishment of a central bank, but on account of the provincial jealousies the scheme did not fructify and in the place of a central bank the Imperial Bank of India was established.

The origin of the bank determined to a great extent its constitution, organisation, and administrative machinery. Although it was not a central bank, because it had no right of note issue and no control over a concerted and co-ordinated policy of currency, credit and exchange, yet it performed some of its important functions, like serving as a government bank and as a bankers' bank to some extent. The old, privileged and proud position of the bank as a semi-government institution was adversely affected by the establishment of the Reserve Bank of India in 1935. It was now a big commercial bank and acts as an agent of the Reserve Bank of India with which it has entered into an agreement, and has been freed from a number of restrictions imposed before.

The shareholders of the old Presidency Banks, which were purchased as going concerns, automatically became the shareholders of the Bank. The old directors were also retained as the directors of the local boards. A central board of management was created which holds its meetings in rotation at all the three presidency towns turn by turn.

Share Capital of the Bank: The authorised capital of the Bank is Rs. 11,25,00,000 divided into 2,25,000 shares of Rs. 500 each. The paid-

up capital is Rs. 5,62,50,000 and the Reserve Fund amounts to Rs. 5,70,00,000. Of the paid-up capital Rs. $3\frac{3}{4}$ crores consist of 75,000 fully paid shares of Rs. 500 each and only Rs. 125 per share have been called up and paid, on 1,50,000 contributory shares of Rs. 500 each. The remaining $\frac{3}{4}$ value of these shares is reserve liability of the owners.

Management : The direction, supervision and control of the affairs of the bank was vested in a Central Board consisting of two managing governors nominated by the Governor-General on the recommendation of the Central Board; the Presidents, Vice-Presidents, and Secretaries of the Local Boards to represent the shareholders of the different areas ; the Controller of Currency or any other officer nominated by the Governor-General-in-Council; and four non officials nominated by the Governor-General-in-Council to represent special interests of the tax-payers and the public. Of these the Controller was an ex officio member and like the secretaries of the Local Boards was entitled to attend the meeting of the Central Board but was not authorised to vote. In addition, the Governor-General had reserved the right to issue instructions if the financial position or the safety of the Government balances were vitally affected by the acts of the bank. The Controller acted as the watch-dog of the Government and had a suspensive veto in these matters until final decision of the Governor-General-in-Council. The chief function of the Central Board was to exercise general control over the Local Boards, and to look to the general policy of the bank regarding discount, the

distribution of funds, the fixing of bank rate, and the publication of weekly statements. As the Central Board could not meet very often, a Committee of two members was appointed in order to deal with emergencies, known as Managing Board. There were three Local Boards consisting of the Presidents, Vice-Presidents and secretaries in the three Presidency towns of Bombay, Calcutta and Madras. The Central Board was to meet once in a quarter of a year at least alternatively at the three Presidency towns. The Local Boards were to carry on their routine work, and to supervise the business of their respective territories.

The bank was required to open 100 branches within five years of its coming into existence, the location of 25 of which was to be determined by the Central Government. By 1923 the bank had 126 branches and three sub-agencies, and by 1936 it had 164 branches.* It was allowed to open a branch in London but was prevented from carrying on foreign exchange business directly for the public. The London office of the bank transacted such of the business as was entrusted to it by the Secretary of State, rediscounted bills of exchange for the Exchange Banks, acted as a custodian of the cash balances of the Government of India, and represented Indian commercial interests. It was allowed to borrow money in the London money market on the security of its assets but was not entrusted with the flotation and management of the sterling loans of the Government of India.

It had 390 branches and offices in 1940.

It was further precluded from doing general banking business for all customers except the former ones of the Presidency Banks. While many of the restrictions imposed on the Presidency Banks were removed some of them were retained.

In lieu of the responsibility of the bank to stimulate the development of joint stock banking by opening 100 branches within five years of its existence and to exercise an effective control over the discounts, advances and deposits of the commercial banks, the bank was authorised to carry on certain Government and central banking functions. The *functions of the bank* were, therefore, of two types: *Government* and *commercial.* The main *government functions were* (*i*) keeping of Government balances freely at its offices and the carrying on of the general banking business of the Government *i. e.*, receiving money on their behalf and making payments, (*ii*) management of the public debts, (*iii*) remittances of Government money, (*iv*) lending on securities on behalf of Government and issue of government loans.

The *commercial functions* of the bank were the same as those of the Presidency Banks which consisted of: receiving money on deposits for fixed periods on payment of interest, receiving valuables and securities for safe custody, buying and selling of gold and silver bullion or any property that might have come into its possession in the satisfaction of its claims, borrowing of money in India or London on the security of its assets, transacting agency business on commission, issuing letters of credit and bank post bills payable in

India and Ceylon, making inland transfers from one branch to another, drawing bills of exchange and letters of credit, payable outside India and the accepting, selling and discounting of the same as well as buying and selling of bills of exchange to such banks as might be approved; drawings of bills of exchange and the issuing of letters of credit payable out of India for the use of their private constituents, for *bona fide* personal needs and buying for the purposes of meeting of such bills and bills of exchange payable out of India at any usance not exceeding six months, investing funds in authorised securities such as trustee securities, securities of the Government guaranteed railways, debentures issued by the District Boards, and Government securities, acting as administrators in winding up estates, advancing money against the above securities and against bills of exchange and promissory notes or against goods or documents of title assigned to it

Forbidden business: On account of its special responsibilities it was subject to certain restrictions, the most important of which were: it could not carry on foreign exchange business and compete with the Exchange banks; it could not lend money for a longer period than 6 months; it could not advance or lend money on the security of its own stock or shares, it could not lend on mortgage, or security of immovable property or documents of title thereof save in cases of estates (Courts of wards); it could not lend more than one lakh of rupees to any firm or an individual on an unsecured overdraft; it could not lend or discount

bills for an amount exceeding 20 lakhs to any individual or partnership firm except on the security of trustee stocks, funds, and securities, securities issued by certain state-aided railways, the debentures and other securities issued by district boards under the authority of the Legislature, and goods or documents of title relating thereto; it could not discount bills or make advances on personal security without the endorsement of two persons or firms unconnected with each other in general partnership.

Moreover, the bank by providing remittance facilities at reasonable rates to the public and to other banks, by keeping their cash balances and by rediscounting their commercial papers during the busy season for which it was authorised to borrow 12 crores of rupees from the Paper Currency Department, and by managing the clearing house *acted as a bankers' bank*, but, as it carried on all the functions of an ordinary joint stock bank, it competed with other banks. It had no right of note issue and had no control on exchange. Hence it was not a full-fledged central bank.

Changes introduced on account of the establishment of the Reserve Bank: When the R. B. of India came into existence certain necessary changes were introduced into the Imperial Bank. It ceased to be Government banker. As it was no longer a privileged semi Government institution, the government control over it was relaxed, the Controller of Currency has ceased to be a member of the Central Board (though a Government officer can

atterd the meeting of the Central Board and take part in discussion but he can not vote) and the Governor General nominates only two persons instead of four, and the Managing Governor is appointed by the Central Board directly, and the Governor General therefore has no business to issue instructions now to safeguard the financial policy or the cash balances of the Government. Similarly the restrictions on the business of the London Office of the Bank have been done away with, and it has been empowered to open branches abroad or in India. It has further been allowed to deal in foreign exchange, to make loans for nine months instead of six, as in case of other bills, against agricultural bills and against movable or immovable property to courts of wards, to lend money or open cash credits on the security of the Reserve Bank shares and security of municipalities and against goods hypothecated or pledged. It can also buy, sell, draw, accept and discount bills of exchange out of India and borrow outside India.

The Central Board now consists of Presidents, Vice-Presidents and Secretaries of the Local Boards and one person each elected from amongst the members of the three Local Boards at Bombay, Calcutta and Madras ; a Managing Director and a Deputy Managing Director appointed by the Central Board, two persons nominated by the Governor General who should not be officials of the Government, and certain persons who might be representatives of any new Local Boards. The Central

Government can nominate one member to the Board who can attend meetings but cannot vote. There are 15 members of the Central Board at present and seven of the local boards each at Bombay and Calcutta and six at Madras.

Agreement with the Reserve Bank: The agreement is for 15 years after which it will hold good until terminated by a five years' notice on either side. As per the agreement the Imperial Bank is the sole agent of the Reserve Bank throughout British India where it had a branch when the Reserve Bank came into existence in 1935, and where there is no branch of the Banking Department of the Reserve Bank. It performs the usual banking functions of the Central and Provincial Governments and the Railway Board in such places on behalf of the Reserve Bank. The Reserve Bank is to pay remuneration to the Imperial Bank for this agency business for the first ten years at the scale of 1/16% of the first 250 crores, and 1/32% on the remainder of the total annual receipts and disbursements on Government account. After 10 years the scale is to be revised, and thereafter, it is to be paid on the basis of the actual cost to the Imperial Bank. For maintaining the branches which existed at the commencement of the Reserve Bank Act 1934, the Imperial Bank is to get 95 lacs of Rupees in 15 years from the Reserve Bank as follows: 9 lacs per annum for the first five years; 6 lacs per annum for the next five years and 4 lacs per annum for the next five years.

Its Services and Achievements

The Imperial Bank of India has rendered yeoman services to the cause of joint stock banking during the last twenty one years of its existence. By opening a number of branches and offices (390 at present) throughout the, country and, especially in places where there was no office of a bank before, it has stimulated the development of banking by inculcating the habit of thrift and banking. It has trained a large number of men in the modern methods of banking required for its branches and to that extent has relieved unemployment among the educated classes. It has improved the banking standard of the country by its sound principles. It has abolished the former system of decentralised reserves in the form of treasury and sub-treasury balances and by handling the Government balances has relieved the monetary stringency during the busy season and prevented the bank rate from rising very high. It has introduced a little bit of elasticity of currency by providing rediscounting facilities to other banks and by advances to them on the security of Hundies and bills of exchange. Its branch in London has meant a closer touch with the London money market and has enabled its customers to get trustworthy information about English concerns. The mobilisation of the millions of the treasury balances has immensely increased the banking power of the country and has enabled the bank to provide finance for internal trade It has provided cheap and ready transfer of funds from one part of the country to another to the

banks which have no branches at the place of transfer at a maximum rate of 1 anna per cent for sums of Rs. 10,000 or over and to banks transferring between branches at the rate of only half an anna per cent. It charges -/4/- upto 1000,-/2/- between 1000 and 10,000 and -/1/- for sums over 10,000 from the public. It has done the financing of the internal trade by advances to shroffs and of industry by advancing clean loans and produce loans. The former is granted on pro-notes signed by two persons and on a personal guarantee of some of the shareholders of the concern as in case of the cotton and jute mills. The latter is granted on country produce stored in the godowns of the bank. 'It also discounts hand bills for approved customers which are purely financial bills. ''Growing crops have never been financed except by grant of clean loans on the personal guarantee of two sureties.' The concentration of the reserves has meant economy and efficiency in their movement for providing business accommodation. Through the bank the government has been able to float loans cheaper and has succeeded in tapping the small investors.

However, the bank being a private shareholders' bank entrusted with the monopoly of government banking business has failed utterly to act as a guide, friend, and philosopher to other banks in times of need. It has been prevented from carrying on foreign exchange business upto 1935 and, therefore, from financing the foreign trade of the country and, hence, the monopoly of the exchange banks hasbeen left intact. It is a European

The following table shows the progress of the Bank since 1921.

(In Lakhs of Rupees)

Year 31st Dec	Paid up capital	Reserves & Rest	Public Deposits	Private Deposits	Cash Balances	Invest-ments	Loans and advances
1921	5,62½	4,14	6,80	65,77	13,60	...	...
1922	5,62½	4,33	14,15	57,00	15,07	...	...
1923	5,62½	4,55	8,56	74,19	15,01	...	...
1924	5,62½	4,80	7,50	76,71	15,60	...	...
1925	5,62½	4,92	5,46	77,83	17,46	...	...
1926	5,62½	5,09	6,45	73,89	20,90	...	...
1927	5,62½	5,24	7,20	72,07	10,89	...	...
1928	5,62½	5,39	7,95	71,30	10,58	...	...
1929	5,62½	5,48	7,60	71,64	14,00	...	...
1930	5,62½	5,53	7,37	76,60	13,01	...	...
1931	5,62½	5,14	8,32	63,86	11,04	...	...
1932	5,62½	5,42	7,07	68,36	20,97	...	...
1933	5,62½	5,49	6,44	74,13	18,60	...	...
1934	5,62½	5,66	6,72	74,28	18,97	...	...
1935	5,62½	5,47†	*	79,10	19,59	46,88	21,58
1936	5,62½	5,50†	...	78,80	8,56	52,59	26,76
1937	5,62½	5,50†	...	81,08	13,43	47,62	29,37
1938	5,62½	5,55†	...	81,51	8,99	43,72	38,30
1939	5,62½	5,60†	...	87,84	11,09	38,02	48,28
1940	5,62½	5,62†	...	96,03	24,83	48,57	32,31
1941	5,62½	5,62½†	...	108,92	15,27	64,40	38,88
30th June 1942	5,62½	5,70†	...	137,17	38,16	75,54	33,29

The Bank has paid a dividend of 16% from 1921-31 and of 12% free of incometax since 1931. It is the strongest and a privileged joint stock bank and its shares have always been quoted at a very high premium.

*The public deposits were transferred to the reserve Bank of India in 1935.

†Excludes balance of profits.

manged bank and this fact has failed to inspire confidence into the Indian joint stock banks who have very much resented, and resented rightly, its privileged position and unfair competition in matters of ordinary banking. It has collaborated with the exchange banks in discriminating against the Indian joint stock banks and other institutions in various respects. It has not provided for the training of Indians for technical and higher posts and its scheme of training Indians has not at all worked satisfactorily. It utilised the Government balances without any charge and did not pay anything to the government even from its profits as the Reserve Bank does at present. It had no control of note issue and could not therefore co-ordinate currency and credit and control effectively the banking system through its bank rate. The control exercised by the government through the Controller of Currency had not been so effective as it ought to have been. It still continues a somewhat privileged position as the sole agent of the Reserve Bank and this is very unfair to other banks.

CHAPTER XIII

EXCHANGE BANKS

Exchange banks are the agencies of foreign banks and associations which, as their name implies, specialise in dealing with the foreign exchange business. They have a monopoly of

financing the foreign trade of India and do it mostly with the buying and selling of foreign bills of exchange. The total foreign trade of India averages annually more than 600 crores of rupees but it is a pity that most of this trade is financed by foreign banks and their agencies and no Indian joint stock bank, except the Imperial Bank of India since 1935 and the Central Bank of India, which started a branch in London in 1936, has the equipment or the resources or necessary technically qualified staff or branches abroad in international monetary centres to carry on this business Unfortunately the Central Bank branch was amalgamated in 1938 with Barclay's Bank. Legally the Indian joint stock banks are not prevented from undertaking the business of dealing in the foreign exchanges, but, on account of the formidable competition of the well and long established Exchange Banks, with their vast resources and easy access to international monetary centres, they are precluded from engaging in this line of business.

The E. I. Co. which had a monopoly of trade regarded the business of exchange as peculiarly its own and it was only when this monopoly was broken in 1853 that the first exchange bank was established. The origin of the exchange Banks is to be found in the discount and acceptance houses which were started towards the second half of the eighteenth century to provide remittance facilities to European settlers and businessmen in Calcutta, Bombay, Madras and Rangoon etc. Messrs. Thomas Cook and Sons are the survivors of these old agency houses which specialise at

present in tourist traffic business. We had in 1933 eighteen exchange banks in our country with 85 branches, eight of which were English, three Japanese, two American, one French, two Dutch, one Portuguese and one of Taiwan. Since 1934, the Imperial Bank of Prussia has closed its branch at Bombay; now we have only 17 Exchange banks with 98 branches. Germany, Italy and Belgium are the only important countries in trade relations with India who have no exchange banks of their own here. Among the Indian banks, the Alliance Bank of Simla and the Tata Industrial Bank did some exchange business but the first was liquidated in 1923 and the second was amalgamated with the Central Bank of India in the same year. Thus, the foreign exchange business is the practical monopoly of the foreign banks here. The policy of open door in banking and exchange has led to the representation of many nationalities and makes a national solution of the problem very difficult indeed. Gradually these banks have extended their activities away from the handling of foreign exchange business and financing of foreign trade, and are now formidable competitors in the ordinary business of banking.

Broadly speaking the functions of these banks are:—

1. Financing of the export and import trade.
2. Buying and selling of gold and silver.
3. Discounting of foreign bills of exchange.

4. Provision of remittance facilities to foreign lands.

5. Financing of the internal trade to some extent and the carrying on of the ordinary business of banking.

The financing of the foreign trade of the country is split up into two processes:—

(a) Financing of the trade from port to port; and

(b) Financing of the trade from port to inland up-country trading, collecting and distributing centres and *vice versa.*

The first part of this foreign trade of the country is financed by the exchange banks which regard it as their close preserve and do not allow any Indian joint stock bank through unfair competition to engage in it. Only fifteen to twenty per cent of this lucrative business is in the hands of the children of the soil.

The financing of the export trade is done in the following manner :—The London importers of Indian produce open credits with the London Banks and Finance houses and advise of the same to the Indian exporter through the exchange bank. The Indian exporter then after complying with the customs formalities draws three months, sight draft against such credits on D/A or D/P terms. The bill of exchange together with a copy of the invoice, of the Bill of Lading, of Marine Insurance Policy and a Letter of Hypothecation is purchased by the exchange bank which sends this documentary draft on to London, gets it accepted by the bank concerned, endorses it and discounts it in the open

Market. Then in the London money market this documentary bill is rediscounted with the Bank of England with two British signatures. The exchange bank in this way receives sterling for its rupee payments in India. Sometimes when the business is dull the bill instead of being sold and rediscounted is held till maturity and sometimes it is sent for collection through the exchange bank. In such cases therefore the Indian exporter has to wait till the maturity of the bill for the receipt of the amount of the bill and loses therefore interest on his capital invested. Moreover, most of these bills are drawn in sterling or in terms of foreign currencies and therefore he loses on account of changes in the exchange rate as well.

The financing of the import trade is done either by sixty days' sight drafts on D/P terms drawn on Indian importers or by London Banks' acceptance of house papers. In the first case the bills are drawn by foreign exporters on Indian importers and documents of title delivered to the Indian importer only when he has paid for the bill. These bills are also usually in foreign currencies and sterling. In the second case the exporter draws a bill on the London Office of the foreign bank which accepts the bill on behalf of the Indian importer and the drawer then discounts it in the London money market. The accepting bank forwards the relative documents to its branch abroad for collection of the proceeds from the foreign office of the exporting firm and the proceeds are sent to London before the bill matures in order to enable the accepting bank to pay the bill on maturity. In both these

cases these bills are drawn in sterling and in the former case interest at 6% per annum is payable from the date of the bill to the date of the arrival of the funds in London. In the latter case the importer benefits on account of a lower discount rate as London is an international money market.

Complaints against Exchange Banks

1. *Their hostile attitude towards Indian aspirations both political and economic:* The exchange banks regard themselves as part and parcel of British Commerce, are the members of the Associated Chambers of Commerce, and they have consistently opposed the grant of responsible self-government to the nationals of the country and of fiscal autonomy. A proof of this statement is to be found in the views and memoranda submitted by the Exchange Banks' Association before the various committees and commissions on Indian Currency, Exchange, and Tariff Problems. The institution of the elaborate system of commercial and economic safeguards in the Indian Constitutional Act 1935 was done mostly at the instance of these banks so that their vested interests should not be jeopardised by any national government. The absence of the gold standard with gold into active circulation in India is also due to their constant opposition.

2. *Unfair competition with Indian joint stock banks in even inland trade and a close monopoly of the foreign exchange business:* The exchange banks do not in reality, as they allege, confine themselves to the financing of the foreign trade of the country, the tourist traffic, and dealing

in precious metals, but with their long experience and enormous resources compete unfavourably with the Indian joint stock banks in securing customs from Indian businessmen and Indian firms in the matter of attracting deposits and carrying on the ordinary business of banking for them. They finance internal trade at Cawnpore, Delhi, Amritsar etc. Not only this, they do not allow any Indian bank to engage in the foreign exchange business by underselling it. If any Indian bank is courageous enough to engage in the business it is killed by the exchange banks acting in common; *e. g.*, the Tata Industrial Bank and the Alliance Bank of Simla and Central Exchange Bank of India. A proof of the former charge is to be found in the recent absorption of the Allahabad Bank with its branches all over the country in upcountry towns and centres in the Lloyds Bank.

3. *Undue discrimination between Indian and non-Indian firms and business houses in the matter of rendering services and in insurance and shipping etc.*: The Indian banks are prevented in a number of ways from becoming the members of the clearing house, managed and controlled by the exchange banks in co-operation with the Imperial Bank of India. They do not accept marine and fire insurance policies executed with the Indian insurance companies and other Indian concerns. The same is the case with Indian shipping companies.

4. Their directorate being non-Indian, they *do not allow facilities to Indians for training for the higher and technical posts nor employ Indians on them.*

5. They collect funds from Indian depositors and send them to their countries to be employed more profitably and thus *cause a monetary stringency in Indian money market during the busy season to the detriment of inland trade and business.* On the other hand, the exchange banks claim that their connection with international monetary centres enables them to draw upon those markets in times of need and thus ease the situation.

6. The services rendered by them are *very dear* as is evident from the fact that interest is charged on import bills at the rate of 6% both ways from the Indian importers from the date of the drawing of the bill to the date of the arrival of the proceeds in London.

7. They have *no confidence in the integrity and character and business like dealing of the Indian firms* and businesses which is a reflection on the national honour of Indians. They suffer from a very bad and virulent type of racial prejudice and abhor the idea of social intercourse with Indians to such an extent that even the tallest among the Indians who live in European style are debarred from the membership of their clubs and associations.

8. They have their *capital in foreign currencies* and in matter of dispute they are *governed by the laws of their own countries* and not by the British Indian Law, although they carry on their business in India, among Indians and with Indian deposit. Indians are precluded from

becoming shareholders of these banks, have no voice in their management or in their directorate.

9. Banking may be regarded essentially a key industry and as such it ought to be open only to the nationals of the land and no foreign element should be allowed to exploit it. This is the rule in every country of the world except this unfortunate land where, not only the foreigners are permitted to carry on the business of banking without being subject to the law of the land, but they claim it as a matter of right, and regard it as a close preserve and monopoly, which the Indian banks should not be allowed to enter.

Restrictions Proposed

1. No foreign bank should be allowed to carry on the business of banking in India without a specific license from either the Finance Member of the Government of India or the Reserve Bank of India including the existing banks. The majority of the Central Banking Enquiry Committee however, did not favour this discrimination as regards the existing banks.

2. Their capital should be in Rupees and should be open to Indians for subscription.

3. Seventy-five per cent of the directorate should consist of Indians.

4. Adequate facilities should be provided by them for the training of Indians for appointment on the higher and technical posts.

5. A comprehensive banking legislation

The following table shows the progress made by these banks since 1913

Exchange Banks*

Year	No of Banks	Capital, Reserves and Rest	Deposits in India	Cash Balances
		£	£	£
1913	12	37,825,000	23,276,000	4 411,000
1923	18	140,103,000	51,332,000	10,869,000
1924	18	130,464,000	52,976,600	12,275,000
1925	18	138,311,000	53 909,000	7,062,000
1926	18	148,003,000	53,354,000	8,046,000
1927	18	160,919,000	49,931,000	6,198,000
1928	18	187,927,000	51,086,000	6,012,000
1929	18	227,625,000	50,604,000	6,785,000
1930	18	193,616,000	54,794,000	5,782,000
1931	18	185,964,000	50,604 000	6,605,000
1932	18	173,846,000	51,799 000	7,200,000
1933	18	143,080,000	53,080,000	5 040 000
1934	17	141,618,000	53 650,000	5,762 000

*These banks are divided into two groups, those whose considerable portion of business is in India i e. which have 25 per cent or more of their deposits in India, and those which are merely agencies of foreign banks having less than 25 per cent of their deposits in India.

Year	Number	Paid-up Capital	Reserve	Total	Deposits in India and Burma	Cash balance in India and Burma
		£ (1000)	£ (1000)	£ (1000)	Rs (1000)	Rs (1000)
1935 A	7	10,019	8,985	19,004	50,49,65	7,73,22
B	10	69,029	49 001	118,030	25,68,68	4,81,86
1936 A	6	7,019	5,367	12,386	34,34,47	6,34,07
B	13	60,830	55,076	115,906	40,88,08	4,01,24
1937 A	6	7,019	5,358	12,377	33 68,33	6,51,74
B	12	59,342	56,593	115,935	39,52,68	4,06,31
1938 A	5	4,425	5,032	9,457	28,33,97	3,77,27
B	13	63,540	58,519	122,059	38,86,45	2,67,14
1939 A	5	8,625	5,605	14,230	30 32,52	3,08,62
B	14	60,884	50,151	111,035	43,75,30	4,30,14
1940 A	5	4,425	4,000	8,425	35,45 48	4,59,78
B	15	64,994	55,267	120,261	50,11,99	11,93,50

There were 17 Exchange Banks working in India and they had 98 branches at the end of 1940. Three operated in Burma only.

A=25% or more deposits in India and Burma, B=less than 25% of deposits in India and Burma.

opened a branch in London to carry on foreign business, but it has closed it.

With the establishment of the Reserve Bank of India, all these exchange banks were enlisted in the second schedule to the Reserve Bank of India Act 1934 as scheduled banks, and like others, they have to maintain the minimum balance of 5% and 2% of their demand and time liabilities in India respectively with the Reserve Bank and submit weekly or monthly statements of their positions to it. Thus, to some extent they have come within the orbit of the Indian banking system, but there is no effective control exercised by the Reserve Bank over them. Their deposits in India and Burma increased from Rs. 67,20 lakhs in 1938 to Rs. 74,03 lakhs in 1939 and to Rs. 85,57 lakhs in 1940. Their cash balances in India and Burma increased from Rs. 7,39 lakhs to Rs. 16,53 lakhs.

CHAPTER XIV

(A) CO-OPERATIVE BANKS

Co-operation may be defined as the voluntary association of weak and isolated individuals for common economic benefits with an emphasis on the moral and educative aspect with a view to develop the man himself. A co-operative credit society or bank is such an association of the economically weak and needy individuals who combine together to develop thrift and self-help among themselves and derive the benefits of mutual and

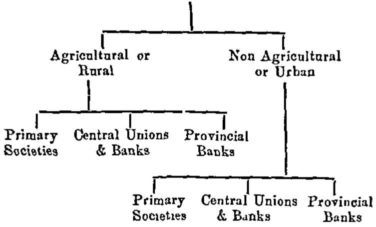
did not provide for the organisation of central and provincial co-operative banks for financing and controlling the primary credit societies nor did it provide for non-credit societies. It further provided for free but compulsory audit of their accounts by government inspectors, for the establishment of provincial co-operative departments under Registrars and granted a number of valuable concessions and privileges like exemption from income-tax, stamp and registration, concessions in money order commission on money sent from one society to another and the freedom of the interest or shares of a member of the society from liability to private debts. Upto 1912 there was only Rs. 75 lakhs of capital in the entire movement when the Act of 1904 was amended, and although the new Act provided for the development of other forms of co-operation, yet credit element preponderates even to-day. Then, the Maclagan Committee in 1914 reviewed the working of the entire movement and made very valuable suggestions for its impovement and further extension. It recommended the establishment of Provincial Co-operative Banks and an All-India Co-operative Bank. In response to this, provincial banks have now been established in all provinces except U. P., N. W. F. P. and the centrally administered areas of Delhi and Ajmer-Merwara. The Reforms of 1919 made Co-operation a Transferred Provincial subject under an Indian minister, and since then a great stimulus has been given to its development by consolidation and rectification of the existing societies and by encouraging the development of new ones. The

Act of 1912 had been replaced by new provincial acts in Bombay in 1925, Burma 1927, Madras 1932, Bihar and Orissa in 1935 and in the Punjab it is in progress. Provincial enquiry committees have also been set up and have reported in U. P., C. P., Madras and Burma, and all-India surveys and inquiries have been made by the Agricultural Commission, the C. B. E Committee besides local investigations by Provincial B. E. Committees. All these reports contain a mess of valuable information and suggestions for the improvement of the movement in all its aspects. Finally, the establishment of the Agricultural Credit Department of the Reserve Bank of India and the rural uplift and reconstruction movement organised by the Congress ministries have infused a new spirit in the movement and given greater emphasis on the development of all-round co-operation by the establishment of multi-purpose societies.

The movement has made a very steady progress, but its success is greater in Bombay, Madras and the Punjab, because the cultivators there can offer mortgagable right in the land, while, in other provinces, Zamindari system prevents such rights of tenants. The C. B. Committee found that there were about 100,000 societies with 50 crores working capital out of which only 14 crores was made up of shares and Reserves and the remainder of deposits and loans and the movement had touched 15 million people if an average family consisted of five persons. Since then the progress has been very rapid and in 1936-37 there were 1,10 9 ›7 societies with 47,18,141 members and 1,01,59,55,000

Rupees as working capital. The overwhelming majority of these are primary rural credit societies. The progress of the movement, however, is very disappointing, if the size and population of the country are taken into consideration. Only a small part of the needs of the rural areas is supplied by it, although its benefits are not only economic but social and educational also. It has saved a good deal in interest charges and provided for short and intermediate needs of its members at reasonable rates besides a host of other material, social and educational benefits.

CO-OPERATIVE CREDIT BANKS



Primary Societies

The primary societies form the base of the structure of the co-operative credit movement.

They are associations of borrowers and non-borrowers resident in the same locality. The membership is open to any person of good character without any distinction of caste, creed, and calling so that a spirit of co-operation may be fostered. The area of operation is restricted to a village. *Rural* societies are organised on Raiffeisen model with unlimited liability (ultimately it is a contributory liability) while the *urban* ones are organised on Schulze Delitzsch and Luzzatti models with limited liability or unlimited at their option. A member's liability subsists for two years after the cessation of membership. A Haisiyat or Property Register is kept for record of tangible assets of the society. They obtain their funds by shares, (U.P., Punjab, Madras and Burma) by deposits from non-members and sympathisers, and by loans between $\frac{1}{4}$ and $\frac{1}{8}$ of the value of net assets only from Central and Provincial Banks and State. The contribution of share capital is, however, not essential. The C.B. Committee recommended an encouragement of the method of subscription and deprecated the attraction of deposits from non-members at high rates of interest. They are to act as savings banks and promote thrift.

Loans are granted to members only and to non-members with the sanction of the Registrar. The maximum value of shares held by an individual is restricted as also his right to transfer or charge his shares, which are exempted from attachment or sale by courts or in insolvency proceedings. Every member has only one vote irrespective of shares held. An elected committee

with a president and a paid or elected secretary, under the general body of shareholders, looks after the management of the society which has a prior claim, except in case of government dues, to other creditors of its members for agricultural loans. But there is no specific charge and the prior claim does not apply to all advances for crop financing. The Bombay Provincial Act has converted this prior claim into a first charge and the C. B. Committee has recommended the same to be done elsewhere. Loans, based on their objects and the repaying capacity, are granted to the extent of 50% of individual assets of the members for cultivation expenses, purchase of fodder, implements, and cattle, payment of land revenue, redemption of debts and mortgages, personal maintenance, litigation and ceremonial expenses but not for speculation and wasteful expenditure. Unproductive loans are given sparingly for smaller amounts and shorter periods than productive loans. They are advanced mostly on personal security of the borrowers and sureties and sometimes on the mortgage of property. The rate of interest varies from province to province and within the province itself. If there are reasonable grounds, like failure of crops for default in payment, extension is usually granted. All societies have to create and maintain reserve funds out of profits: societies without share capital carry the entire profit to an indivisible reserve; whereas those with shares credit a substantial portion to the indivisible reserve and distribute the rest as dividends. Expenses on education and charity are also provided. Some

societies give loans out of the reserve to their members, while others deposit them with the central banks. The C. B. Committee has supported the latter practice and pleaded for the grant of loans in lieu of these deposits at concessional rates to the societies concerned.

The urban credit banks are the most suitable agencies for non-agriculturists, small traders and artisans, and, on account of the difficulty of opening branches by the Imperial and other joint stock banks in smaller towns and *talukas*, there is an imperative need and wide scope for the development of these urban banks in India. The number of such banks was only 5,936 in 1936-37. The Banking Enquiry Committee and the Foreign Experts advocated the establishment of such banks in as large numbers as possible. Their development will act as the most powerful lever for the revival of cottage industries.

Besides these artisans' societies a large number of other non-agricultural credit societies have of late come into existence. These are the People's Banks of the Luzzatti model in Bombay, Madras etc., the thrift and life insurance societies of the Punjab Madras and Bombay ; the Salary Earners' Societies for Government and business employees in Bombay, Bengal and Madras ; the Communal Societies ; Factory Workers' Societies in important industrial centres ; and the Depressed Classes Societies of Bombay. All these societies aim at the encouragement of thrift and saving by providing facilities for investment in small amounts and some aim at the redemption of old debts.

Central Banks and Unions:—Even before the Act of 1912 provided for the registration of central societies as powerful agencies to organise, control and finance the primary rural and urban banks, a large number of central unions and banks had come into existence.

The primary credit societies in a certain area are affiliated or federated to a central society of individual members and primary societies. They are usually found in headquarters or other big towns of a district. If the membership of a central society is confined to primary societies only it is then called a *Banking Union*, which may be either a 'guaranteeing union' as in Burma, or a 'supervising union' as in Madras and Bombay; or 'Banking union' as in the Punjab. The Maclagan Committee recommended the establishment of guaranteeing unions in all places where there are primary societies and central banks. When the membership consists of both primary societies and individuals then the central society is called a *Central Bank* which may be capitalist, mixed and pure. The former is dominated by individual shareholders and does not exist in India, while the mixed type comprising both primary societies and individual shareholders gives preference to the former in management and share capital and it is considered as the most suitable for India under the existing conditions and is most prevalent in all provinces. The pure or the ideal type comprises only societies as members and is found mostly in Punjab and Bengal. The Maclagan Committee and the C. B. Committee recommended that the

societies should have a dominating voice in the management, although the latter thought that individuals should not be eliminated. Their liability is limited.

The central banks are higher financing agencies and a link between the primary societies, the Apex Banks and the money market. They finance the primary credit societies and act as balancing centres to them as regards their working capital. They raise funds and lend to the primary societies on co-operative principle either directly or through guaranteeing unions and very often look after their organisation and supervision through their staff of inspectors. Their area of operation ordinarily extends over a district. They also transact ordinary commercial banking to some extent. Their working capital consists of their own share capital and reserve, deposits of various kinds from individuals, local bodies and primary societies, over-drafts and short term loans from the Imperial Bank and some other joint-stock banks and loans and advances from the Apex or Provincial Banks and very seldom from other central banks (because such interlocking of liabilities is dangerous). The dividend paid by them is restricted by statutory rules and does not exceed 9%; their lending rates are usually higher than borrowing rates by 3%. Twenty five per cent of their net profits must be allocated to the reserve fund. To pay the claims of the depositors they are required to keep sufficient liquid resources in cash balances, unutilised cash credit with the Imperial Bank and Government promissory notes. The Maclagan Committee and the Reserve Bank of India have emphasised the

necessity of maintaining fluid resources and attracting adequate long-term deposits. The Central Banking Committee proposed the institution of a bad debt fund out of the annual profits in addition to the reserve fund to provide for losses caused by non-payment of loans by some of the societies. The Committee also proposed the coupling of a reserve liability with the limited liability of the primary societies only to increase protection to depositors and public confidence in them. These banks should so marshal their loans to the primary societies as to ensure sufficient repayment of cash to meet the withdrawal of deposits and should get cash credit and discounting facilities for elasticity of their operations.

Provincial Banks:—The Central Banks are federated into bigger central societies called Provincial or Apex Banks which co-ordinate and control the working of, and act as financing agencies and balancing centres of working capital to, the Central Banks. They act as a link between the provincial money market and commercial banks on the one hand, and the credit societies and banks on the other. They grant cash credit and discounting facilities to Central Banks. Ordinarily they do not deal with the primary societies directly except in places where central banks do not exist and they are conducted on business lines. They admit a large number of individual share-holders but steps should be taken to give a dominating voice in their management to co-operative institutions. They get their working capital from their own share capital contributed by the affiliated central

banks and individuals, reserve fund, various kinds of deposits from the well-to-do urban classes, primary societies and central banks and short-term loans, cash credits and overdrafts from the Imperial and other joint stock banks. They lend to the central banks and primary societies and through them funds flow to the individual borrowers in the villages. Except the conditions imposed on granting of loans, the apex banks have no control or supervision on the central banks. They are also required to keep sufficient fluid resources and cash reserves for meeting the withdrawals of deposits, and for elasticity of their operations they have cash credit and overdraft arrangements with the Imperial and Commercial banks and carry on the ordinary business of banking. They have been kept on the 'approved list' of the Reserve Bank of India and like scheduled banks get free remittance facilities and rediscounting of co-operative paper- cash credits and overdrafts facilities.

There are 11 Provincial Co-operative banks: 9 in British India in Madras, Bombay, Bengal, Bihar & Orissa, the Punjab, Burma, the C. P. & Berar, Assam and two in Mysore and Hyderabad States. U. P. so far has no such bank and the establishment of one is badly needed. The Provincial and Central Banking Committees laid great emphasis on it. All these banks have formed the Indian Provincial Co-operative banks' Association for co-ordination, and promotion of common interests and for supplying information as to each other's financial needs. The Maclagan Committee had recommended the establishment of an All

India Apex Bank to provide rediscounting facilities and elasticity of operations to the Provincial Apex Banks, but now that the Reserve Bank provides such facilities there is no need of an independent All-India Co-operative Bank. However, it should not be inferred from this that the Reserve Bank having central banking functions to perform can play the role of an All-India Apex Bank. It can only help the Provincial Banks to tide over temporary financial stringency by acting as 'the lender of last resort'.

Relation with the General Banking System :— The co-operative societies have offered a strong competition to indigenous bankers and money-lenders and having Government protection they inspire a better confidence Inspite of this the relations between them have been generally cordial and the indigenous bankers help the societies in many ways. There seems to be little close competition between the commercial and co-operative banks for the present because their respective spheres of activities lie widely apart, but it has been alleged by the joint stock banks including the Imperial Bank that in matter of attracting deposits specially on account of their privileged position, and in purchasing drafts and selling remittance etc., there has been recently an unfair competition from the Co-operative Banks. This allegation, however, as reported by the Banking Committees, is not well founded. The Governor of the Imperial Bank suggested before the C. B. Committee that Co-operative Banks should confine themselves to co-operative banking and should not be allowed to compete with the commercial and indigenous

bankers in other banking work. But the Committee did not agree and recommended that they should be allowed cheque transactions, and granting of credit on current accounts and remittance business. The Assam Committee suggested that Central and Provincial Banks should deposit their surplus funds with the larger commercial banks and the latter should lend to the former during the slack season. Closer connection between the two was also emphasised by the Burma Committee and C. B. Committee supported both these views. In matter of produce loans competition may be expected in future.

We have already pointed out that cash credit and overdraft facilities are granted by the Imperial and some other joint stock banks to the Central and Provincial Co-operative Banks. The Imperial Bank has been doing it against Government and other authorised securities and demand pro-notes of borrowers and the societies. However, the Bank has been less willing in recent years to extend this financial assistance against societies' pro-notes for short loans and has demanded Government securities instead. This has been due to the excessive overdues, inefficient audit and control of the societies and the difficulty of selling the land of the members of the societies in the long run. The C. B. Committee therefore stressed the importance of the Imperial Bank granting more liberally these facilities of cash credit and overdraft to the Central and Provincial Banks on co-operative paper. The Bank has agreed to deal with the matter more sympathetically in case of

pro-notes of sound societies of *A* class. As to free remittance facilities the C. B. Committee recommended that the Imperial Bank should not reduce the facilities in this behalf under the rules of the Central Government and for remmitace regarding non-co-operative purposes, in should give the same concessions to these banks as it gives to the joint stock banks.

The Reserve Bank now gives free remittance facilities for co-operative purposes and for others at a nominal charge between its office centres and the Imperial Bank does so between its branch centres. Finally, the Agricultural Credit Department of the Reserve Bank has linked the co-operative banks with it and through them provides cheap and adequate credit facilities to agriculture in the following manner :—

The Provincial Co-operative Banks have been made Scheduled Banks and get rediscounting facilities. The Reserve Bank has been allowed to buy, sell and rediscount agricultural bills and pro-notes endorsed by a scheduled bank or a provincial co-operative bank, drawn for the purpose of financing seasonal agricultural operations, or the marketing of crops, and maturing within 9 months. It is authorised to make loans or advances for 90 days to provincial co-operative banks and central land mortgage banks declared to be provincial co-operative banks and through them to co-operative central banks and primary land mortgage banks against the security of (*a*) government paper (*b*) approved debentures of recognized land mortgage banks, which are declared trustee securities.

and which are readily marketable. Further it can extend advances for 90 days to provincial co-operative banks against the security of (a) pro-notes of central co-operative banks and drawn for financing seasonal agricultural operations; (b) pro-notes of approved co-operative marketing or ware-housing societies endorsed by provincial co-operative banks and drawn for the marketing of crops; and (c) pro-notes of provincial co-operative banks supported by ware-house receipts or pledge of goods against which a cash credit or overdraft has been granted by the provincial co-operative bank to marketing or ware-housing societies.

Defects and Suggestions for improvement:—The co-operative movement in India suffers from many serious defects. *Firstly, there is an excessive and vexatious official control which makes the movement mechanical and checks the development of the true co-operative spirit, self-help and sense of responsibility among the members.* The government have taken a vigorous initiative in developing the movement and have judiciously avoided the policy of financial spoon-feeding because it is very undesirable. The C. B. Committee recommended that in the interest of the tax-payer and of the fostering of self-help and self-reliance in the co-operators, the government should give only temporary financial aid to the societies to tide over an emergency. As regards official control and supervision, since 1921 there had been a tendency to liberalise and deofficialize, as far as possible, the movement on the recommendation of *the Maclagan Committee* and others, but since the

recent depression there has been a tendency in the reverse direction. The C. B. Committee therefore recommended a relaxation of official control to popularise the movement and to develop a sense of responsibility and self-confidence among the members.

Secondly, there has been no proper separation of long term, intermediate, and short-term credit supply to the cultivators. To remove this the primary societies should be restricted to the financing of short-term and intermediate credit needs only, and for the supply of long-term credit land-mortgage banks should be established.

Thirdly, there is a lack of knowledge and proper understanding of co-operative principles and essentials of rural credit among the members. The supreme importance of educating and supervising illiterate masses of cultivators and teaching them to manage their own affairs has not been realised. The Co-operative Departments and Institutes should take special steps to provide adequate and efficient training to official and non-official staffs of the societies and the services of school teachers and retired officials in rural areas should be requisitioned, and trained secretaries should be appointed. The Government should spend more on such education of staff and members.

Fourthly, audit is defective and does not conform to the statutory provisions partly because of the paucity of auditors and partly because audit, supervision and inspection, which are allied functions, are performed by different agencies and this

causes over-lapping, and waste of efforts and money. Inefficient and incomplete audit causes mismanagement, embezzlements and loss of public confidence. Co-operative audit includes examination of overdues, and of the revaluation of assets and liabilities. For efficient audit, supervision and inspection of the societies, district unions registered under the Co-operative Societies Act should be formed of the primary societies of the area. The managing boards of the unions should be composed of representatives of the societies and specially trained government officials and the staff should consist of persons licensed by the Registrar. These unions should provide training to candidates for appointment on the auditing, supervising and inspecting staff of the co-operative organisation. They should work in close co-operation with central banks and should be federated into a Provincial Union or affiliated to a specially created audit branch of the Provincial Co-operative Institutes.

Fifthly, the control and management is inefficient and this breeds many defects. The managing committees in many places are not properly controlled by the general bodies and appropriate large loans to themselves. Loans are granted recklessly and extensions given without reasonable reasons. Repayment of loans are neglected by members and still no action is taken against them. This results in excessive overdues. There is a tendency not to liquidate the societies even if their condition is irreparable. Proper distinction between various forms of loans and credits is not drawn

and accounts are not kept properly or upto-date nor the assets of the societies revised carefully. Thus, "the fundamental principle of true co-operation is lacking *Overdues are highly excessive. Audit is defective, Control is inefficient.*" To remove these serious defects, the economic purpose of the loans and the repaying capacity of the borrowers should be properly scrutinised at the time of granting loans Loans to the members of the managing committees should be granted only in general meetings and supervisors and central banks should see that excessive amounts have not been given. Extensions for repayment should be granted only in exceptional circumstances and defaulters should be dealt with severely. The period for repayment should vary according to the needs of borrowers but should not be more than 3 years. To avoid the evils of bad management, if the *Panchayat* of a society grants loans in excess of the limits fixed by its by-laws or otherwise, then the members of the Panchayat should be held personally responsible as guarantors of the loans. Concentration of control into the hands of a fewer number of members prevents smaller producers from getting adequate finance, and in case of central banks it leads to over-financing to keep up dividends, high interest on deposits and superfluous deposits. Special steps should be taken to avoid it and the members should be taught to get rid of dishonest office-bearers. The property statement of the societies should be kept up-to-date and prepared carefully.

Sixthly, co-operative finance is very often

inelastic, dilatory and inadequate chiefly because of the inefficiency or selfishness of the managing committees. Inconvenience, delay and inadequate loans drive the cultivators to the money-lenders. Many societies borrow as much as they can from central banks once a year and lend to the members in lump sums in the expectation that the finance would last the whole year; but the members spend the loans as fast as they can and then depend on money-lenders for their future needs. To avoid these defects the *normal credit* system should be introduced. In this system the society fixes the credit limit of every member in advance and arranges for the necessary funds in time in the form of cash credits with central banks and then lends to the members as they need. The members pay interest only from the time when the finance is availed of. Applications for crop finance can be made and sanctioned beforehand. The grant of cash credit on current account and cheque transactions should be introduced wherever possible to arrest the evils of inelastic and dilatory co-operative finance.

Seventhly, co-operative credit in many provinces is much too costly because of the intermediate agencies—the primary, the central and the provincial co-operative banks—which have to provide for their working expenses out of the difference between the borrowing and the lending rates. The primary societies do not ordinarily work as the 'savings and loan' banks of their villages and balancing centres for the demand for and supply of money; they are mere agencies for distribution

of funds except in Bombay, obtained from the outside agencies. To reduce these rates punctual repayment by members and reduction in overdues; borrowing by central bank at cheaper rates and utilisation of surplus urban money in the slack season and reduction in their working expenses, direct tapping of savings by the rural societies; and a closer co-operation between the central and provincial banks should be effected. Moreover, the profits of the societies and banks should be exempted from super-tax as also their earnings from investments in government securities and debentures of land mortgage banks, and they should be exempted from court fees and stamp duties.

The co-operative societies and banks should collect savings deposits and encourage saving during plenty for use during scarcity; cheque transactions should be developed; the banks (central and provincial) should be managed by men trained in banking and co-operation; the central and provincial banks should be co-ordinated and there should be the fullest co-operation between the Agricultural and Co-operative Departments. To finance the marketing of crops on a co-operative basis loans should be given liberally to the societies and central banks for the erection or purchase of godowns in the *mofussil*.

Suggestions of the Agricultural Credit Department of the Reserve Bank of India :—With a view to the rectification and consolidation of the co-operative movement, the Reserve Bank in its Statutory Report has made the following suggestions :—

The overdues and long-term loans should be separated from short term loans and placed on a proper footing. For this purpose the overdues should be reduced to such an extent that they may be cleared out of profits within 20 years by being written off from reserves in part and recovered in part from sale of members' assets and the remainder spread out in instalments and transferred to land mortgage banks. Such a course will prevent withholding of further finance or wholesale liquidation of societies in arrears.

The societies are advised to build up strong reserve funds by keeping adequate margin between their borrowing and lending rates. This would help them in meeting losses during crop failures when the members are not able to repay loans. Remissions and extensions can also be granted. It is feared in certain quarters that this would raise the interest rates.

Loans in future should be restricted to productive purposes like cultivation expenses, implements and cattle etc. and loans for other unavoidable purposes should be reduced to a minimum and kept within the repaying capacity of the cultivator, who should be discouraged from living beyond his means. To secure this, he should be prevented from borrowing from more than one source and his total liability should be limited according to the value of the land or its rental.

The primary credit society, being the pivot of the whole movement, should be reconstructed on sound lines to enable it to secure to the cultivator the benefits of not only cheap but guarded

credit but also the benefits of "better living, better farming, and better business". It should be a multi-purpose society and bring the entire life of the cultivator within its ambit. It should be composed of members who understand the basic principles of co-operation and are imbued with the co-operative spirit of self-help and self-reliance. It should inculcate habits of thrift and investment by inviting members to deposit and take shares. The primary societies should be federated into small banking unions on the lines of the banking union at Kodinar in Baroda for conducting the allied functions of finance, supervision, and education. They should be induced to take up joint marketing of agricultural produce of their members and should be linked up for this purpose with the central sale societies. This would secure the benefits of handling produce in bulk, uniformity in quality and storage and collection. They should have their own godowns and supply improved seeds to their members. The central and provincial banks should be re-organised to maintain fluid resources, adequate reserves and should be in closer contact with commercial banks of class *A*. The co-operative staff should be trained intensively in co-operation, rural economics, and banking.

Recently the grant of Rs. 15 lakhs by the Central Government to the provinces has led to the starting of valuable co-operative training schemes in the various provinces, and the powerful drive of the congress ministries in eight provinces for rural uplift and reconstruction has given a very

welcome and healthy stimulus to the development of multi-purpose co-operative societies. It augurs well for the future, and one may cherish the hope that, if the co-operative movement is revitalised and conducted on sound lines, as suggested by various committees and commissions, there is no reason why co-operation must not be the most potent factor in the social, educational and economic regeneration of the stagnant villages and their teeming millions in India.

Reserve Bank and Co-operative Banks

The Agricultural Credit Department of the Reserve Bank is rendering very valuable services to the co-operative bank and societies not only through its suggestions and advice for their improvement and greater serviceability but also through the provision of remittance facilities and financial accommodation to the co-operative central banks through the provincial co-operative banks. It keeps in touch with the various aspects and problems of co-operation, rural indebtedness and debt legislation, rural reconstruction and land mortgage banking. It advises on these and other cognate matters the Central and Provincial Govts., Registrars and co-operative banks, societies and others interested in rural credit and finance. In addition to the issue of various bulletins on village banks, banking unions, land mortgage banks, debt legislation and regulation of money-lending and schemes for the revitalisation of the co-operative movement it has also studied the financing of agriculture by central banks and governments in

foreign countries, cattle and crop insurance, consolidation of holdings, licensed warehousing, audit, inspection and supervision of societies and issues the statistical returns and annual review of the co-operative movement.

Under the new scheme of remittance facilities (1st October 1940) given effect to from the 1st Sept., 1941, additional remittance facilities have been given to the provincial co-operative banks and central banks affiliated to them on the same principles as the scheduled banks. For co-operative banks and societies the minimum exchange on drafts and mail transfers for amounts upto Rs. 5,000 is annas four only. Upto 30th June 1942, the provincial co-operative banks of Bombay, Madras, Sind, the Punjab and Ajmer availed of these facilities.

As to *financial accommodation*, the Bank provides agricultural finance only indirectly through the provincial co-operative banks in times of emergency or seasonal stringency. Even then, because the loans have to be repaid within the prescribed time, the provincial co-operative banks run on approved banking lines cannot use them for long term or continuing finance. In its circular letter dated 14th May 1938 to the provincial co-operative banks, the Bank while suggesting the procedure and conditions of getting accommodation by them from it, laid down the fundamental condition that the provincial co-operative bank must maintain with the Reserve Bank a minimum daily balance equal to 2½% of its demand and 1% of its time liabilities in India and it should

submit periodical statements in prescribed forms. It also explained the implications of the sub-sections 2(*b*), 4(*a*), 4(*c*), and 4(*d*) of sec. 17 of the Bank Act under which it has been required to grant financial accommodation to the provincial co-operative banks:

(*a*) advances against Government securities for not more than 90 days to p. c. banks and through them to central co-operative banks

(*b*) advances against approved debentures of recognised land mortgage banks declared trustee securities, if they are readily marketable.

(*c*) discount of treasury bills.

(*d*) loans for 90 days to co-operative banks against promissory notes of approved co-operative marketing or warehouse societies endorsed by the p. c. banks and drawn for marketing or rediscount of such notes maturing within 9 months; or loans and advaces for 90 days on pro-notes of p. c. banks secured by warehouse warrants issued by corporations independent of the borrower or on pro-notes supported by documents of title to goods assigned or pledged as security for cash credits or overdrafts granted by the p. c. banks to approved marketing or warehouse societies.

(e) advances for 90 days against pro-notes of central banks endorsed by p. c. banks and drawn for seasonal agricultural operations or the marketing of crops, or rediscount of such notes maturing within 9 months. These

Co-operative Banks

Class A :—Banks with capital and reserves of Rs. 5 lakhs and over
(In thousands of Rupees)

Year	No. of Banks	Paid-up Capital	Reserves and other funds	Total	Deposits and loans	Loans outstanding	Cash Balances
1930—31	27	1,58,88	97,04	2,55,92	12,57,38	10,69 60	88 23
1931—32	34	1,72,32	1,34,70	3,07,02	15 01,60	11,47,99	1,11,57
1932—33	36	1,86,49	1,72,33	3,58,82	18,09,77	11 41 67	2,46,80
1933—34	35	1,92,19	1,60,86	3,53,05	17 11,99	11,66,57	1,90,51
1934—35	41	2,18,61	2,03,85	4,22,46	17,93,94	13,11 10	2,07,37
1935—36	44	2,39,19	2,42,44	4,81 63	19 89,56	14,47,16	2,79,48
1936—37	45	2,49,81	2,50 10	5,00,91	20,56,71	15,25,26	2,41,06
1937—38	40	2,23,87	2 56,41	4,80,28	19 79,05	14,99,95	1 72,08
1938—39	43	2,40,62	2,94,68	5,35,30	22,92,48	18,33,66	2,03,36
1939—40	41	2,43,21	3,05,01	5,48,22	22,94,33	18,91 00	1,90,06

Madras	12	Sind	2	Bihar	1	Punjab	5	Hyderabad	1
Bombay	7	Bengal	7	U. P.	1	C. P.	3	Mysore	3

Co-operative Banks

Class B :—*Banks with capital and reserves of Rs. 1 lakh and less than Rs. 5 lakhs.* (*In thousands of Rupees*)

Year	No. of banks	Paid-up Capital	Reserves & other funds	Total	Deposits & Loans	Loans outstanding	Cash balances
1930—31	172	2,09,01	1,26,29	3,35,30	17,66,15	13,85 18	66,66
1931—32	197	2,31,57	1,46,05	3,77,62	17,75,04	13,99,32	97,73
1932—33	215	2,45,16	1,82,88	4,28,04	20,64,73	14,01,61	1,51,83
1933—34	226	2,52,12	1,99,62	4,51,74	15,99,84	13,74,46	1,16,67
1934—35	229	2,44,42	2,20,38	4,64,80	15,40,61	13,46,53	1,22,35
1935—36	244	2,48,39	2,43,00	4,91,39	14,94,12	13,36,86	1,52,01
1936—37	255	2 57,06	2,57,94	5,15,00	14,76,41	13,28,15	1,36,65
1937—38	256	2,44,40	2,75,80	5,20,20	15,48,86	13,99,65	1,18,28
1938—39	261	2,50,08	2 84,78	5,33,86	15,85,86	14,45,40	1,05,69
1939—40	277	2,61,43	3,06,60	5,68,03	16,14,43	14,63,01	1,26,52

Madras	34	Orissa	7	Assam	1	Baroda	4	Coorg	1
Bombay	37	U P.	15	Ajmer-Merwara	2	Travancore	3	Burma	2
Sind	8	Punjab	36	Mysore	9	Cochin	1		
Bengal	63	Delhi	1	Gwalior	4	Indore	1		
Bihar	10	C. P.	25			Hyderabad	10		

advances are made only against papers of first class central banks run on approved banking lines and bearing two good signatures, one being that of a p. c. bank. The bills or notes must be time bills or notes of fixed maturity not exceeding 9 months, be drawn in proper legal form and be free from conditions militating against their free negotiability. Like the scheduled joint stock banks, p. c. banks also do not usually approach the Reserve Bank for financial accommodation; they do so only in case of need. Some of them have received the necessary accommodation in recent years against government securities. On 2nd January 1942, the Bank issued its new scheme of financial accommodation to the central banks through the p. c. banks for financing seasonal operations of agriculture or marketing of crops at special rates. The scheme proposes to grant a rebate up to 1% to p. c. banks rediscounting agricultural bills with the Reserve Bank provided the benefit of the rebate is passed on to the agriculturists. The details of the scheme are being worked out.

(B) Land Mortgage Banks

Agriculture is the premier industry of our country employing more than 73% of the population and therefore its importance in our notional economy cannot be over-emphasised. Credit is of the essence of agriculture *i. e.* for the successful operation of agriculture, cheap and an adequate quantity of credit is necessary. The cultivator requires it for financing current agricultural

operations, for purchasing live-stock, emplements and tools, for permanent improvements on the land, for the redemption of old and ancestral debts and for freeing his land and building from mortgage, for litigation, for conventional expenses like marriages, funeral ceremonies and religious festivals. In other words, he requires, as pointed out by the Central Banking Enquiry Committee, *three types of credit: short term, intermediate* and *long term credits*. Practically all the operations of husbandry described above require finance for long periods. The co-operative credit society can, on account of its organisation, technical and legal rules, supply him only with short term credit, and that too for productive purposes only. For the rest of his needs the farmer depends entirely on the village sahukar or money-lender who is a grain-dealer-cum-money-lender. The Mahajan keeps his purse strings always loose, is prepared to advance money for any purpose, whether productive or otherwise, provided the farmer can give a valuable security in the form of his land, building or the standing crops etc. He charges an exorbitant rate of interest (usually compound) and therefore agricultural indebtedness has increased enormously during recent years. The C. B. E. Committee estimated it in the neighbourhood of 900 crores of rupees but on account of the unprecedented trade and agricultural depression during recent years, when agricultural prices fell by 50%, this indebtedness must have increased to at least 1200 crores. As the co-operative society cannot afford to supply all the requirements of

the farmers, and specially their long term credit needs, so there must be special institutions to do it. Such institutions are the Land Mortgage Banks.

The loans advanced by co-operative societies to their members and by the central financing agencies to their constituent societies are from the very nature of the source from which they derive the bulk of their finance for short and intermediate terms only. By concentrating upon the growth and multiplication of rural credit societies and, thus upon facilities for short and intermediate term loans, the co-operative movement did not provide for the redemption of old debts or for increasing the earnings of agriculturists which alone would prevent any further increase in the debts and pave the way for paying of the old ones. It does not seem to have been adequately realised that the removal or lightening of the heavy load of indebtedness does not depend so much upon easy terms of co-operative finance as upon the determination of individual indebtedness to the sahukar, upon so fully financing the cultivator that he could be prevented from going to the Mahajan any more, and above all, on making agriculture an industry profitable enough to leave a reasonable surplus over all legitimate expenditure on agriculture and the household so that the saving would be applied to the liquidation of old debts. The mistaken idea that co-operative credit would serve this purpose, and which still clings, is largely responsible for increasing that load still further. Short or intermediate loans can, if judiciously employed, prevent any further increase in the debt,

though even that in the present state of uneconomic agriculture seems scarcely possible : but it cannot leave any adequate margin of saving to redeem past follies or misfortunes. The Sahukar as adverted to above, is the village retailer as also the purchaser of the villagers' produce, and what he cannot recover from the borrower by way of interest or the part payment of the principal, he can more than make good on the threshing floor or in his shop. *The co-operative movement by concentration on the supply of cheap capital or credit has attacked him only on one front so that the risks of non-payment are saddled on the society while the profits of the merchant and the retail shopkeeper are still enjoyed by the Mahajan :* the attack ought to have been on all fronts. Under the circumstances, however, the clarification of the situation of the indebtedness is very important before the tackling of the problem of redeeming old debts. The C. B. E. C. has emphasised, therefore, the need for a vigorous policy of debt redemption on a voluntary basis and for exploring the possibility of undertaking legislation to secure, if need be, the settlements of debts on a compulsory basis. A Rural Insolvency Act, as recommended by the Royal Commission on Agriculture and endorsed by the C. B. E. C. would also be an important step towards liberating those who have already given up all their assets from the incubus of ancestral or old debts so that at least they and their heirs could start with a clean slate. Still, however, the need for long term loans to the cultivators for land improvement and for redemption

of old debts is obvious, and therefore, the establishment of the Land Mortgage Banks has recently taken place.

A land mortgage bank may be defined as an institution "which raises funds by issue of debentures, bonds and shares etc. and by receiving deposits for long terms and employs such funds in financing the long term credit requirements of agriculture. There are three types of Land Mortgage Banks:—*Co-operative, Quasi-Co-operative* and *Commercial*. The co-operative type of Land Mortgage Banks is an association of borrowers who raise credit by the issue of mortgage bonds bearing interest and made payable to bearer. It is meant for mutual help and is not organised for profits. It is illustrated by the German Land Schaften. The commercial type is represented by the Credit Foncier-de-France which works for profit and declares dividends. The third type is an association of both borrowers and non-borrowers with a share capital and a limited liability. This is represented by the Austrian and Hungarian Land Banks. The banks organised so far in India are in a sense of co-operative type, though strictly speaking, they belong to the Quasi-Co-operative variety, admitting as they do to the membership a few non-borrowing individuals for attracting initial capital as well as business talent, organising capacity and efficient management.

There are 12 L. M. Banks of the co-operative type in the Punjab; two of which work over whole districts, while the rest work only over Tahsil areas. In Bombay there are 15 L. M. Societies,

and one central L. M. Bank, in Bengal, U. P. and Assam 5 each, while Madras has over 100 primary L. M. Banks and a Central L. M. Bank. The chief objects for which these banks advance loans are the redemption of old debts, improvement of land and methods of cultivation, and the purchase of land in special cases. The C. B. E. C. is of the opinion that for long time to come the resources of these institutions will be mainly required for enabling the cultivator to redeem his land and house from mortgage and to pay off his old debts. One feels, however, extremely doubtful whether the emphasis should not be laid on the intensive and extensive development of agriculture, because unless agriculture becomes a paying industry, the redemption is impracticable and illusory. The bulk of the funds of these banks will have to be raised by debentures and for these purposes there will have to be in the provinces a Central Land Mortgage Bank as in Madras and Bombay to help in the debenture issues. According to the C.B.E.C the Govt. will also have to help these banks for the success of the debentures issued by guaranteeing the interest as in the Punjab and in special cases by purchasing debentures of a certain value. The success of these institutions in the case of the co-operative variety lies in mutual knowledge and control together with unlimited liability, that in the case of the limited liability L. M. Banks depends on the capacity and business habits of the directorate, sound valuation of security, careful investigation of titles, correct assessment of borrowers' credit and repaying capacity and efficient management of affairs.

Loans for redemption of debts, and for purchase and improvement of lands are given to members on mortgage of lands upto 50% of their value in some provinces, while in others upto 30 times the land revenue payble on them. Before the granting of a loan a thorough inquiry is made into the member's title to the land, his rights to alienate, his repaying capacity and need for the loan. The period of the loans varies from 16¼ to 20 or 30 years in different provinces and the interest varies from 8 to 9 per cent. To provide small agriculturists with long-term credit through mutual association and collective guarantee of their properties the R. Agricultural Commission and the Banking Committees have suggested the establishment of co-operative land mortgage banks of the German type. They should be registered under the Co-operative Societies Act with certain safeguards, limitations and privileges. And for the supply of long term credit to the large land-owners etc. they have suggested the development of land mortgage banks on the joint-stock principles as has been done in England, France, Ireland, Egypt and Japan.

The co-operative land mortgage banks raise their capital by issuing shares to be subscribed initially or out of grant of loans, and then by issue of debentures through a Provincial Corporation and the interest on them is guaranteed by the Government or the principal is sometimes purchased by them. These are declared as trustee securities and part of the share capital is sometimes provided by the Provincial Government.

when a large capital is required for business by these societies. Commercial banks also raise their capital by shares and debentures and a part of the capital is provided by Provincial Government in the beginning or interest on debentures is guaranteed and they are made trustee securities. Loans are repayble in easy instalments.

For further development, the co-operative land mortgage banks should be given summary powers of recovery by sale and foreclosure and the Land Alienation Acts and Transfer of Property Act should be suitably amended. Multi-purpose societies should be developed and greater co-ordination between societies and land mortgage banks should be established and Government should give more help.

The Reserve Bank of India, being precluded from granting long term loans, can only give limited financial assistance to land mortgage banks, Those c. l. m. banks which are declared p. c. banks under the Reserve Bank Act obtain loans for 90 days against government securities in emergencies. The Bank helps them also by buying their debentures, or by granting loans to them on a government guarantee of both the principal and the interest if they are marketable. In a note published recently the Bank has suggested certain improvements in flotation of debentures and their retirement by land mortgage banks and circularised with it a model form of balance sheet to all the central land mortgage banks.

There were during 1938-39, 226 l. m. banks and societies with *79,596* members and *with*

Rs. 5,35 lakhs of working capital made up of share capital, debentures, deposits, loans and reserve funds.

Co-operative Societies 1938-39

(In lakhs of Rupees)

Provincial Banks		Central Banks	Agricultural Societies		Non-agricultural Societies	
			Credit	Non-credit	Credit	Non-credit
No.	10	594	93,767	11,504	6,690	3,831
Working Capital	12·85	29·42	31·61½		27·23	

(C) Post Office Savings Banks

Post Offices in India also form part of the money market and provide important investment and banking facilities to the middle-class and the lower middle classes of people with slender incomes. They provide very important remittance facilities to the entire population. The investment and banking facilities are the provision of deposits and withdrawal of funds in the Savings Banks, the purchase of cash certificates, buying and selling of government securities on behalf of depositors free of any charge and the issue of life assurance policies.

Government Savings Agency managed by the Accountant General and the Sub-Treasurer had

been started in 1810 to take the place of the Agency Houses. This agency business was extended by Lord W. Bentinck between 1833 and 1835 to the Presidency Towns when the Government Savings Banks were started. In 1856 the Bank of Bengal was appointed banker to these and the management of these Banks was entrusted to the Presidency Banks between 1863 and 1865. It was contemplated to open branches in other important towns in 1840 but evidence is lacking with regard to their actual starting in them. In connection with certain selected district treasuries, District Savings Banks were opened in 1870. *The post Office Savings Banks were started in 1882 and 1883 and absorbed the district savings banks in 1886 and the Government Savings Banks of the Presidency towns in 1896.*

Ever since the start, the Post office savings banks had continued to progress rapidly and at the eve of the Great War there were 9,824 banks with Rs. 23·16 crores of deposits and 16,39,000 depositors. During the Great War there was a set-back and, owing to panic, a large number of depositors withdrew their deposits. But it was only a temporary phase and, with the ready response of the Government to meet the demands for withdrawals in full, confidence was soon restored. After that there has been a rapid advance again with a temporary set-back in 1930-31 due to the world economic depression. In 1935-36 there were 12,926 savings banks with Rs. 67·25 crores deposits and with 35,41,553 depositors. By 1937 and 1938 the deposits had increased to

Rs. 74·68 and Rs. 79·65 crores respectively. The deposits in India only were Rs. 81·94 crores in 1939, Rs. 78·38 crores in 1940 and Rs. 59·57 crores in 1941. Still there is a vast field for expansion in a country where there are 5 lakh villages in British India alone. Lakhs of villages are still devoid of these facilities.

These savings banks are found at all head post offices, sub post offices and a few branch post-offices. They are administered by the Postal Department. The Government do not maintain any specific reserve against the savings banks deposits but their general balances are a security against the deposits. Their main object is the promotion of thrift and investment habit and the discouragement of hoarding among the middle, the lower middle and the working classes, but the industrial workers and peasants do not make practically any use of the facilities, provided by them. It is due to mass illiteracy, poverty and chronic indebtedness, and to the inadequacy of the facilities in the rural areas. A majority of the depositors are professionals and teachers, servants of Government and public bodies. Current Accounts are not allowed at these banks. The amount to be deposited in an account in a single year is limited to Rs. 750, and the total amount is limited to Rs. 5000 for an adult and Rs. 1,000 for a minor. Accounts can be opened by an adult in his own name or in the name of his wife and minor children. The minimum amount to be deposited at any time is four annas and withdrawals can take place only once a week. For every

depositor a Pass Book in English or local vernacular is issued and the details as to date, amounts and deposits or withdrawals are entered into it. The Pass Book must be presented either in person or through a messenger for every deposit or withdrawal. The rate of interest was reduced from 3% to $2\frac{1}{2}$% in 1933 and to 2% in 1936 and to $1\frac{1}{2}$% later on, and it is calculated on the lowest monthly balance of an account between the 4th day and the end of the month.

Recently these savings banks had to face competition from co-operative societies, commercial and exchange banks and from War loans of the Government. The various Banking Committees have made a number of suggestions to improve the facilities given by these Savings Banks. Some of these proposals are :—

(1) Permission to open joint accounts payable to the survivor and assignment of the deposit by the depositor,

(2) raising of the minimum limit in case of minors,

(3) deposits and withdrawals by cheques,

(4) higher rates of interest like other agencies,

(5) removal of restrictions with regard to the number of withdrawals in a week, transfer of money from one account to another,

(6) increase in the number of the banks, which, if not payable, should be opened for two days of the week and worked in group with neighbouring post offices and the opening of such offices in a few larger towns two or three evenings of the week,

(7) heads of factories and offices should be allowed to open accounts on behalf of their employees and the services of the primary school teachers should be enlisted to run them in the country-sides.

The second important service rendered by the Post Offices is the facility for the buying and selling of Government securities through them free of charge. The investor can take delivery of the securities or leave them in custody of the Deputy Accountant General, and he may purchase securities even if he is not a depositor in the savings bank. He can invest in any government loan directly or through the savings bank, through the post office upto a maximum of Rs. 5,000 in each year after deducting rhe sales through the post office. The post offices also sell on behalf of the investor free of charge the whole or part of Government securities purchased through them and held by the investor or kept under custody of the Deputy Accountant General, provided that he is a savings bank depositor at the time of sale and that, if a part alone is sold, the balance has a face value of Rs. 100 or multiple thereof. Interest on the securities, if held in the custody of the Accountant General Posts and Telegraphs is drawn and credited to the depositor's account and no income-tax is charged on it. No fee, commission, or brokerage is charged for purchase, sale, safe custody, delivery or drawing and remittance of interest. If securities liable to income-tax are purchased and left in custody of the Deputy Accountant General the maximum limit is

Rs. 22,500. It has been suggested that greater publicity should be given to these facilities to enable their use by a larger number of investors.

The third important service regarding thrift and investment rendered by the Post Offices is the provision of cash certificates which since the Great War (1917-18) have attracted a large amount of capital from the middle classes. They are issued in amounts of Rs. 10 and multiples thereof at a discount and are payable in full only at the end of five years. The maximum holding of a person is limited to the face value of Rs. 10,000. The interest on them is free of incometax and has been gradually lowered from 6% to $2\frac{1}{2}$% per annum. If they are cashed within one year of purchase, no interest is paid and thereafter it goes on rising progressively. These certificates provide a very secure form of investment to the middle class with minimum of risk and maximum of yield. The decrease in the yield of other government securities and increase in incometax in recent years has made them more popular on account of the interest on them being free from incometax. The total investment in them has varied according to the conditions to the money market, the rate of interest and general economic conditions of the people. In the immediate past the total amount of cash certificates has increased considerably due to the sale of gold and the investment of the proceeds thereof in them and this inspite of reduction in the interest rate. On 31st March 1936, the value of outstanding certificates was Rs. 66 crores, but it had gone down to about Rs. $60\frac{1}{4}$ crores on

31st March 1938. In order to popularise and extend them it has been suggested that their terms of issue should be made more favourable, that facilities for assignment should be provided, that special certificates payable after 10 years for women only should be introduced and that the village *Patel* and accountant who collect land revenue should be entrusted with the work of these certificates which should be accepted in payment of land revenue. On the other hand, others have suggested their abolition because they prevent deposits with commercial banks on account of their higher yield, while, still others have suggested a reduction in the interest rates. The C. B. Committee has recommended the adoption of a middle course.

During 1938-39, 1939-40 and 1940-41 the value of the outstanding certificates was 59·57, 57·02 and 46·98 crores respectively. The war has affected their sales adversely partly by the introduction of 10 year Defence Savings Certificates with a higher yield. They are sold in multiples of 10 and the maximum holding is limited to Rs. 5000 with $3\frac{1}{8}\%$ of compound interest free of incometax. A new scheme of P. O. S. B. known as Indian P.O. Defence S. Bank a/cs. have been started since April 1941 to enable people of small incomes to help the war efforts. The deposits in these are payable only one year after the war and they bear an interest of $2\frac{1}{2}\%$.*

Finally, the post offices provide facilities for

For a detailed account see Part I, p. 295-298.

both life and endowment assurance to Government servants and employees of local bodies and some universities. They also provide for payment of fixed monthly instalments in lieu of a lump deposit or many annual instalments. The minimum and maximum limits for both forms of assurance are Rs. 100 and Rs. 20,000 respectively and in case of monthly allowances the limits are Re. ½ and Rs. 50/-. The premia on both forms of assurance are paid monthly by the employers from the salaries of the employees. It has been suggested that postal insurance facilities should be open to the public in general, although this view was not favoured by the C. B. Committee. If premia rates are competitive and the facilities are confined to men of moderate means only, we see no reason why the facilities should not be extended to public.

CHAPTER XV

INDUSTRIAL FINANCE

General Survey :—For the development of industries the provision of adequate and cheap credit facilities is very essential. Requirements of industries for capital consist of funds for the permanent equipment of the factory and for extensions and additions; working capital for meeting the day-to-day expenses of the factory, and trade capital for purchase of raw materials. In other words, industries require both long-term and short-term credit. The requirements for long-term credit

are proportionally much greater than for short-term. The initial capital outlay for the purchase of plant and machinery, buildings and premises, fixtures, fittings and furniture, for preliminary expenses in flotation, registration etc.—all these lead to a permanent sinking of funds which a joint stock bank dealing in commercial credit can not provide without inviting trouble to itself. Investment credit, as distinguished from commercial credit, is required for this initial heavy outlay. The financing of industries with regard to these requirements can be done most successfully by issuing long-term debentures or by getting long-term loans and investing them like mortgage credit on the security of land and building, plant and machinery etc. of the industries concerned. Industrial banks therefore are a matter of necessity for financing industries.

So far, however, as the short-term credit requirements of industries are concerned a joint-stock commercial bank can finance them out of its short term deposits on the security of genuine trade or commercial bills or documents of title relating to goods. It is only in this way that the Imperial Bank of India and other joint stock banks provide the financial requirements of industries for short term. They have not played an active part like the German and Japanese banks which have identified themselves completely with industries.

The industrial financing like that of trade finance is in the bands of a foreign institution which is unique in case of India. This institution

is the managing agency system. "The system is the Indian substitute for a well organised capital market and an industrial banking system of western countries, and has come into existence by the sheer pressure of economic circumstances." The Tata Industrial Bank developed during the war years for industrial financing came to grief very soon and is now defunct. The Industrial Commission of 1916 recommended the creation of Provincial Industries Departments which were to make special grants for the development of small scale and cottage industries, to grant technical scholarships and provide technical advice to the industrialists. Long term loans by way of guaranteed debentures, and interest on them, were to be encouraged by the Government. The Central Banking Enquiry Committee of 1929 recommended the establishment of provincial industrial corporations with large sums to make loans and advances on the security of the assets of manufacturing concerns. Such mortgage credit was to be the special feature of these corporations. They were to raise their capital by issue of long term debentures, the repayment or interest on which was to be guaranteed by the Government. The majority of the committee was not in favour of the guarantee of the repayment of the debentures but only of interest. In pursuance of this recommendation the United Provinces Government appointed an Industrial Finance Committee under the chairmanship of the late Sir Pochkhan Wala. The Committee recommended the establishment of an Industrial Finance Corporation which was

to raise its capital by means of debentures. The Corporation has now come into existence with a capital of 50 lakhs of rupees but the major part of it still remains unsubscribed, the chief reason for which has been the strained relations between the employers and the employees and the consequent lack of industrial peace during the regime of the Congress Government. The Benares Bank which took up 6 lakhs of the shares suspended payment in May 1939.

Existing facilities:—Our discussion so far has shown that the capital requirements of industries are generally of two kinds:

(a) Block capital to finance fixed assets, their purchase, replacements and extensions. This is long term capital.

(b) Working Capital to finance the floating assets and for current expenses e.g. purchase of raw materials and stores, for payment of wages and marketing expenses. This is partly long term capital and partly short term. The proportion between the block and the working capital depends on the nature of the industry concerned. In the case of major industries like cotton, jute or sugar factories the initial outlay on block capital is much greater than the working capital whereas in case of small and cottage industries the reverse is the truth.

Whether the existing credit facilities to major industries are adequate or not has been contested. The Indian business community and economists

hold the view that the existing banks do not provide as much assistance to industry as they ought to or as much as is afforded by the banks of other countries, notably Germany and Japan. On the other hand, the European view held by the Associated Chambers of Commerce, the Exchange Banks Association, and the Imperial Bank of India is that industries floated on sound lines and with reasonable prospects of success are able to obtain the necessary block or working capital from the existing banks. They further contend that block capital of industrial concerns should be provided by public or private subscriptions to shares or debentures issued by them and that the commercial banks should only give financial assistance to industries when they are well and long established to present a balance sheet on sound lines; whereas the foreign experts associated with the Banking Enquiry Committee suggested that not only block capital but even working capital should be provided by the industrial concern itself and that it should not apply for financial assistance to an industrial bank until it has been carried on for a sufficiently long period of time to prove its strength and soundness. Any other course to be followed will be dangerous and unsound for the concern and unwarranted for the bank. In other words, financial facilities are adequate in India, according to these people, provided the concerns are sound and adequate security is forthcoming. In actual practice the existing facilities fall short of the requirements of industries It may be true that European industries in India are able to secure

adequate financial facilities because of their close touch with the foreign banks in India. But Indian witnesses before the C. B. Committee showed extreme dissatisfaction with the existing state of affairs and held the view that even the major industries find it difficult to obtain the necessary finance from the existing banks.

One of the chief causes of the lack of adequate industrial finance in our country is a lack of an organised money and capital market not only in the countryside but also in big towns. There is a general aversion among the people to the investment of their resources in industrial enterprises and in the great majority of cases both in industry and agriculture banking facilities do not exist. The illiteracy and ignorance of the rural masses and the apathy of the urban people towards joint-stock banks in general leads to the locking up of a large amount of available capital in purchase of ornaments, land and buildings and whatever is saved from this is either hoarded or lent on high terms of interest to the neighbours or invested in Government and semi-Government Securities. This apathy towards industrial enterprises is accountable partly to the habit and partly to the lack of adequate banking and financial facilities like the investment trust. The initial expenses of opening a branch and of running it in the absence of available business can be successfully met by following the western method of opening the branch for a day or two only in the week. In case of big towns the lack of stock exchanges where industrial securities can be freely bought

and sold except in Bombay and Calcutta and the absence of institutions which can lend freely on the security of industrial shares and stocks and the public belief that the industrial and fiscal policy of the country is not determined by a responsible government prevent the urban people from investing in industrial securities. The existing banking system is too inelastic and insufficient to meet the industrial needs of the country. Moreover the attitude of the banks towards the industries is unsympathetic. In such a chaotic state of credit and of an absence of industrial policy it is not surprising that money has not been forthcoming adequately for industrial finance and such wealth as is available is not turned to the full account. It is therefore imperative for the Indian banks to recognise the importance of adequate industrial finance and to transform their machinery accordingly.

Inadequate facilities provided by Commercial Banks

The joint stock banks finance only short-term credit needs of major industries (cotton, jute, iron and steel etc.), for working capital out of their short-term deposits either in the form of cash credit or a loan. This is a very defective method because there is no certainty of the credit being reserved The stronger banks can utilise their paid up capital and reserves in purchasing the debentures of new industrial enterprises with the intention of transferring them to the public ultimately, but on account of their conservation they do not even underwrite industrial shares or debentures or lend money to a considerable extent against

these securities to provide block capital. The Imperial Bank of India had been prevented by law from giving loans for more than 6 months or on the security of industrial shares or immovable property and therefore it could not provide for capital expenditure of industrial concerns. Even according to the Amending Act of 1934 the Bank has been authorised to lend on the security of fully paid shares of limited companies or immovable property only when the original security is a trustee security but not otherwise. Then even on loans for current finance or working capital against the security of liquid assets, the Imperial Bank keeps a margin of 30% or more so that the industrial concerns have not only to provide block capital for themselves but also a part of the working capital for which they have to pay high rates of interest to indigenous banks Other banks also follow this example. This is very hard on the industries specially when prices are low; and the hardship increases by the disregard of valuable fixed capital by the banks as general security for loans. The personal credit and honesty of the borrowers are ignored for advancing loans and a full backing of tangible and liquid securities is insisted upon. Both trade and industry seek financial assistance from the same bank and in this keen competition industry fares worse. There are no technical experts on the staffs of these banks to evaluate the worth and soundness of industrial securities properly but this difficulty is greater in case of smaller proprietory industries which do not prepare balance-sheets. Then the Imperial Bank is obliged by law

to accept only a two name paper as a cover for an advance and this practice is again followed by other banks for additional securities. Hence, inspite of their solvency, all industrial enterprises have to provide guarantors for loans, and the banks in addition to the specific security become creditors of both the borrower and the guarantor. This second signature is usually of the managing agents of the concern and those which have no managing agents to support them find it very difficult to obtain loans from the banks. Moreover this insistence sustains the undesirable and defective system of managing agents. The interest for these loans has always been very high, usually Imperial Bank rate plus one or two per cent more and this has been constantly changing according to the conditions of the money market and not according to industrial conditions. The rates charged by smaller banks on mortgage and personal surety have been much higher and those charged by the princes, indigenous bankers and merchants have been higher still because of substantial commission paid to the intermediaries for arranging for the loans. Complaints have been made that the executive of the Imperial Bank discriminate between Indian and European concerns in matters of financial aid and advance loans more freely to the European than to the Indian concerns. The Cotton Mills of Bombay and Ahmedabad obtain greater finance by private deposits than by loans from banks. Bombay Mills get 11% and Ahmedabad Mills 39 % of their total finance through these deposits. The deposits are usually

for 6 or 12 months at 4 to 6 per cent interest rates. This system is very bad in periods of depression, is primitive, and unsuited to the requirements of modern industry. Even managing agents find it difficult to supply the mills with adequate finance in periods of general depression. The banks should intervene between the depositors and the mills for the benefit of both parties. The issue of debentures for block capital as recommended by the Foreign Experts is fraught with a number of difficulties like absence of issue houses to underwrite debentures, heavy duty on their transfers, high cost of issue etc.

With regard to the financial needs of small, medium and cottage industries like rice, flour, and oil mills, match, cigarette, glass, lac, and leather factories, cotton ginneries and presses, printing presses, chemical works, hosieries, carpet and silk factories, the various Banking Committees found that they had great difficulties in obtaining the necessary finance. The middle class industrialists suffer mostly on account of lack of acceptable securities with them and therefore, the Imperial Bank and joint stock banks do not provide even working capital to these struggling industries. Friends and acquaintances can not provide adequate finance to them, and hence, they borrow at high rates from the money-lenders, indigenous bankers and get some help from the government under state aid to Industries Acts. These banks do not provide any finance to cottage industries like handloom, silk and wool weaving, gold and silver thread, brassware, belt metal, bidi and

cheroot, rope, mat and gur making, carpet weaving poultry farming, toy-making, dairy and wood carving etc. They suffer greater hardships and the workers in them are in chronic debt to money-lenders and merchants who advance them materials at high prices, lend them at high rates for subsistence and get back the products at low prices and thus make the cottage workers suffer both ways. They are reduced to servitude to the money-lenders throughout their lives.

Suggestions for improvement:—The Imperial Banks of India should develop industrial banking and should give a lead to other joint stock banks which are financially in a strong position. In order to keep themselves in touch with industrial concerns the Indian banks should follow the general principle of helping industries to issue shares and debentures. The Grossbanken of Germany supply a large part of initial capital to industries and subsequently place it among the public for subscription or sell to customers and other banks. If the issue is large the banks join together into a syndicate called a "Konsortium" and each bank undertakes to take up a part of the whole issue. But this investment is not for a long period. The German banks delegate a member of their management to serve on the board of directors of industrial concerns whose share they underwrite. This close connection between the two creates mutual confidence and inspires harmony. The Indian banks can also appoint their manager or their managing directors as one of the directors of the industrial companies financed by them.

Similarly the directors of the bank should also appoint local boards consisting of leading business men of the locality and of bank customers. The banks should follow a more liberal policy of granting loans on the general security of the block capital. They should also lend more freely on the personal security of the borrower provided he is of long standing and undoubted probity. But above all private and public subscription should be developed for the supply of initial block capital, and for extensions and additions fresh issue of share capital or of debentures should be made, and the joint stock banks should give temporary advances on adequate security. But by far the most crying need is the establishment of specialized Industrial Banks for the supply of long term finance to large scale industries. The Central Banking Committee and some Provincial Committees recommended the establishment of Provincial Industrial Corporations to meet the financial needs of the major industries. These Corporations should obtain a large part of their capital by issuing shares but the provincial governments should provide the share of the capital not taken up by the public as this would inspire larger confidence than the government guarantee of capital or interest. The share capital should be supplemented by the issue of debentures of double the value of the share capital and the interest on them should be guaranteed by the government. More funds should be obtained by fixed deposits. The industrial Commission of 1916-18 recommended the establishment of industrial banks and the grant of loans and expert technical advice by the

provincial governments for the encouragement of small and cottage industries. After the reforms of 1919 industries became a transferred subject and the provincial Industries Departments have been making suitable grants to applicants under the State Aid to Industries Acts in Madras, Bihar and Orissa, and Bengal since 1923, and under the Industrial Loans Act in the Punjab since 1930. The aid given has been however very small and a part of it has been written off. It suffers through the administration of the Industries Department. Industrial banks should be established. Provincial Industrial and Credit Corporations have recently come into existence in certain provinces as in U. P., Bengal etc. To complete the structure however there should be an All India Industrial Corporation to co-ordinate the services of all the provincial corporations and to guide and finance them, failing which there should be a Central Association of these corporations. Mr. Manu Subedar suggested the creation of an All India Industrial Bank with branches in important industrial centres. The Government should follow a more vigorous and bolder industrial and fiscal policy and remove other hindrances to the development of industries in the country. For financing of the cottage industries multipurpose co-operative societies should be developed and central stores and trading organisations should be established. "A proper scheme of co-operation between government, the Reserve Bank and commercial banks should release large funds for use in industry which are at present either idle or are diverted into less

useful channels."* There should also be cooperation and coordination of relations between the bigger commercial banks, and the small industrial banks extant.

CHAPTER XVI

CENTRAL BANKS

Functions of Central Banks

A Central Bank is an institution that supplies currency and credit to all other existing banks, and credit institutions of a country, acts as the custodian of national economic interests, as a bankers' bank, as a government bank, and controls and manages the currency and credit policy in such a way as to secure the stability of internal economic structure and the stability of foreign exchanges. It plays the most influential part in the financial and credit organisation of the land and serves as the most effective machinery of currency and credit elasticity. It pools together the reserves of the country into a central national reserve which can be easily and effectively mobilised in periods of national financial emergency. The importance of central banks as the controllers of currency, credit and exchange policy, and as the atbiters of public destinies has increased immensely in the post-war period. In fact the war and its enormous unsettling

*Muranjan : op. cit., p. 157.

effects made the various countries of the world, which had no central banks, feel the necessity for one such institution and the movement towards the stabilisation of currencies and restoration of order in credit supplies gave a fillip to the development of central banking. The international conference at Brussels in 1920 passed a resolution recommending that all countries which had no central banks should establish one at the earliest possible date to enable international co-operation among the various central banks for controlling the currency and credit supplies, and thus for maintaining stability of foreign exchanges. The art of central banking has undergone fundamental changes in the post-war period.

The nature and functions of a central bank may well be illustrated by the Bank of England. Mr. Sayers says in his "Modern Banking" that the fundamental business of the Bank of England is to act as a central bank *i. e.* to control the commercial banks in such a way as to promote the general monetary policy of the state and to support the monetary policy directed by the state. The main functions, however, can be classified into the following five heads :—

1. Note Issuing ;
2. Acting as a bankers' bank;
3. Acting as a government's bank ;
4. Conducting a small amount of ordinary banking business ; and
5. Being the ultimate source of funds for

discount market *i. e.* serving as the 'Lender of last resort'. Mr. Sayers points out earlier in the chapter from which we have quoted that the distinguishing features of a central bank are :

i. that it does not exist to make the maximum profits for its owners *i. e.* its aim is not profit-making but service to the community as a whole,

ii. it controls the commercial banks and does not compete with them *i. e.* it acts as a friend, guide and philosopher to the commercial banks,

iii. that it is subordinate to the state.

Mt. Ram Chandra Rao in his "Present Day Banking" similarly writes that the duties and responsibilities of a central bank are "that a central bank is a great note-issuing institution in which is vested to an extraordinary degree the financial responsibility of a nation, in that, its methods enable it to supply at all times an elastic currency varying automatically with the needs of the country, to maintain an adequate gold reserve, through the regulation of foreign exchange, and to conserve and protect the country's metallic reserves, to control the money market by its regulation of the discount rate, and to serve as a sanctuary for all banks in period of threatened danger."

The functions of a central bank can be summarised as follows :

i. It provides cheap, adequate and elastic currency by having the monopoly of

note issue. The elasticity of currency is secured by the issue of emergency currency in times of need against the security of treasury bills and other gilt-edged securities, and by the provision of rediscounting facilities to the commercial banks. Through its bank rate it regulates the supply of credit; a rise in the bank rate discourages borrowing, while a reduction encourages it. As Mr. Hawtrey remarks in his 'Art of Central Banking', a central bank is entrusted with the regulation of credit and under modern conditions the regulation of credit includes the regulation of money. Money is the nervous centre of industry, and the due functioning of economic activity throughout its entire range is dependent upon the proper regulation of money. A central bank through its regulation of credit can enlarge or compress the consumer's income or outlay by a "release of cash" or an "absorption of cash". A central bank ought to be able to prevent undue fluctuations in the price level, and in an international gold standard the principal central banks ought to concert measures to stabilise the value of gold. Thus it is that a central bank can *maintain stability of internal prices as well as of foreign exchanges through its regulation of currency and credit.*

ii. *It serves as a bankers' bank.* By requiring the various banks of the country to keep a fixed percentage of their time and demand liabilities with it, it pools together the small,

scattered reserves of the country into a central reservoir out of which streams of funds flow through conduit pipes into the productive channels of agriculture, trade, commerce and industry. In this way it controls the commercial banks and does not compete with them. It furnishes the various member banks with liquid funds to lubricate the wheels of business by not only financing them directly, but also by providing rediscounting facilities through a well-developed, closely knit and perfectly organised money market and bill market. It affords to them the same facilities which they provide to their customers. These competitive banks make payments to one another through the central bank with which they deposit or from which they withdraw currency according to their needs and replenish their stock by borrowing from the central bank. These facilities relieve them of the responsibility for the provision of currency. To meet their demand liabilities from day to day they still keep their position liquid by simply maintaining sufficient assets of the kind that can be pledged or rediscounted with the central bank. Therefore, the responsibility of seeing that the supply of currency in the community for various purposes is adequate, and no more than adequate, falls upon the central bank, not because it is usually the bank of issue. Even if it has no power of creating currency through its own notes, still, so long as it never

refuses to lend to any borrower who complies with the customary conditions, the competitive banks can always have additional currency. A central bank, as adverted to above, is the lender of last resort and it is this fact which makes it responsible for the currency. In the absence of right of note issue and the basing of the currency exclusively on a specie standard, the central bank would be absolutely dependent upon its coin reserves to meet any increased demand for currency. The central bank keeps free of interest the reserves of the other banks and utility of the centralised reserves is that it can be very easily and effectively mobilised to meet a crisis in the land.

iii. Its acts as a Government bank being entrusted with the government treasury balances, remittances, and the management of the public debts. It receives money on deposit from the government usually free of charge, all government payments or disbursements are made through it. Public loans are floated by central or provincial or local governments through it and the subscribers to the loans are required to deposit their money with it on behalf of the government.

iv. It co-ordinates the services rendered by various banking institutions by exercising an effective control over the money market through its bank rate which acts as the barometer of the money market. It is through this powerful weapon that the central bank

manipulates exchange, internal price level and the market for loanable funds and acts as the arbiter of public destinies. It is the custodian of the public interests in matters economic, financial and commercial. When the bank reserves are high the bank rate is reduced and credit expands; when the bank reserves are low the rate is increased and credit contracts. Through this regulation of credit, money and credit are made cheap or dear.

v. *It controls, regulates, and manipulates the foreign exchanges and thus controls the inflow or outflow of gold from or into the country.* It buys and sells gold bullion or foreign exchange at fixed parity, and regulates the flow of gold or foreign exchanges through its bank rate.

vi. *It discounts first class genuine commercial bills bearing at least two good signatures one of which must be of a bank or a discount house of repute* In certain countries the central bank *regulates the supply of token currencies as well.*

Private vs. State Bank

A central bank may be either a private shareholders' bank or a state bank. The general tendency in the post-war period is towards the former type. The central bank ought to be immune from political influences. However, whether the bank is state-owned or not the government exercises a decisive and effective control over it. As its bank

rate has very important repercussions on the supply of cash and credit and consequently on the price level, the volume of production and employment, the gold reserves and foreign exchanges, its activities must be regulated by a government charter or by an act of the legislature. Moreover, it handles freely the government balances and has the fiscal advantages arising out of its monopoly of note issue, it is but meet and proper that the government should share in the profits of the bank. Hence, it is usually provided in all cases that after the declaration of a fixed dividend to the shareholders and after the allocation of a surplus to the Reserve, all balances of the net profits should be given to the government. Moreover, as the central bank is the lender of last resort, it is prevented from competing with the ordinary commercial banks. It is prevented from carrying on ordinary banking business, from receiving deposits from the public on interest and from dealing directly with the business community. Central banks are further prevented from lending to businessmen directly or from financing trade and industry directly, they can do so only through the commercial banks. They are further prevented from locking up their funds in permanent investments. They must keep their funds liquid and hence should invest in short term securities or government papers like treasury bills. They are prevented from lending on the security of their stocks or to engage in industry or trade and from making unsecured advances. Further, in some countries they are prevented from carrying on open market operations

except in emergencies. They are also prevented from borrowing in the domestic market ordinarily and from investing in freehold property.

Bank Rate

Bank rate is the rate at which a central bank provides accommodation to other banks on the security of self-liquidating bills of exchange. In other words, it is the rate at which bills are discounted at the central bank. Its working can be best illustrated by the Bank Rate of the Bank of England. The Bank of England buys and sells securities through the stock exchange or in the discount market. On every Thursday in the Weekly Court of Directors, or on special occasions at a special court, it is fixed. It is normally above the rate ruling in the open market. Whether the discount houses rediscount bills at the Bank or obtain advances the rate which they have to pay for the accommodation is normally higher than the rate which has been prevailing in the market. Accordingly when the discount houses go to the bank *i. e.* "When the market is in the Bank" the rates in the market tend to rise, because the discount houses having secured money on unusually high rates will only discount new bills at rates which will compensate them for high cost of obtaining the money with which to buy them. This bank rate is the traditional barometer of the money market. It is the most powerful weapon to control the level of prices and the volume of production. In other words, the banking system influences the behaviour of the entrepreneurs, and

hence, the volume and pricing of production by exercising pressure on interest rates.

The bank rate influences then prices and production but how far it is effective is a question of difference. Concerning this efficacy there are *two main lines of thought*:—*Hawtrey's* and *Keynes'*. According to the former it is the short term rate which affects directly dealers' activities, while, according to the latter, it is the long term rate which is important. Both, however, see banking policy effective because it influences the cost of holding goods. The cost of holding goods consists of warehousing expenses, depreciation, insurance against fire and against fall in price, theft and interest charges. However, interest charges form part of total cost of holding goods, and since the banker can influence total cost as well, and hence, the relative attractiveness of holding goods. If, for example, the bankers make the holding of goods more attractive entrepreneurs begin to add to their holding of goods, prices rise and the volume of production increases. Conversely, if the holding of goods is made less attractive than before, then entrepreneurs begin to reduce their holdings of goods, prices fall and the volume of production is depressed. So far as this goes both of them agree; but their difference lies in the class of goods, the variation in the holding of which is considered more important.

In Hawtrey's view the main variation is in the willingness of dealers to hold working and liquid capital goods *i.e. stocks* of finished and semi-finished goods; and, since the holding of these goods can be

financed by short term loans, the movement of short term rates is sufficient to explain changes in prices and production. The alternative view of Mr Keynes is that the demand for working capital is the result of general situation which is itself determined by the demand of entrepreneurs for fixed capital goods; and, since in the English banking system the holding of fixed capital goods may be financed only by long term non-banking loans, it is the long term rate which is more effective. It should be noted, however, that these two explanations of the effect of banking policy on prices and production are not mutually exclusive: a fall in short term rates may well both stimulate additions to stock and lead to a fall in long term rates which will stimulate investment in fixed capital. The difference is one of emphasis only.

The Hawtrey's line of thought may be illustrated as follows. The dealer is any person who holds stock of finished or semi-finished goods for convenience. The convenience of holding stocks has a certain money value to him and the balances that value against the cost of holding stocks. As the cost of holding stocks rises he thinks it worth-while suffering a slight loss of convenience to avoid the increasing cost *i e.* he reduces his stock; and conversely, the extent to which he changes his stock as a result of a given small change in the cost of holding stocks, may appropriately be called the *elasticity of his demand for the convenience of holding stocks*. The more elastic his demand, the greater will be the effect on his operations of a given change in the cost of holding goods. Now

if short term interest rates rise, the cost of holding stocks rises. The dealers therefore begin to reduce their stocks by buying less rapidly than they are selling. They occumulate a balance or pay off debts and thus absorb cash. The producers finding sales falling off cut prices and curtail output which reduces the volume of employment of the factors of production and money incomes therefore contract. Wage cuts also take place and on account of this the retail sales decline which reduce purchases from dealers who in turn reduce their purchases from wholesalers and so forth. Producers being depressed the replacement of, and addition to, plant becomes less, and therefore, the capital goods trades also tend to decline. Contrariwise, if short term interest rates fall, the cost of holding stocks falls. Dealers increase their stocks, orders to manufacturers rise, output expands, employment increases, money incomes rise, and so do the retail sales. Thus rising prices and production are the result.

Hence, it is clear that a change in the cost of holding stocks is the main-spring of changes in the short term loans and the effectiveness of the bank rate in this case depends on two factors :—

(i) the proportion which the interest charges bear to the total cost of holding stocks, and,

(ii) the elasticity of demand for the convenience of holding stocks. So far as the latter is concerned experience has shown that before and since the war advances have been remarkably unresponsive to changes in

their costs and have in fact generally been one of the last of the various economic series to turn up and down as trade has turned up and down.

The more widely held view concerning the effect of the bank rate is that of Mr. Keynes, and it is that, the main effect of bank rate on the internal economic situation comes through the change in the long term rate which always seems to be associated with any pronounced change in short term rates.

The rate of interest is a price, the price of money now in exchange for money at some later date. There are two markets for investment: short term and long term. When the bank rate changes, its effect is felt not only in the bill market but also on the rates of advances by the joint stock banks and the rates for deposits. With this change in the bank rate a change in the long term rates is also produced. For example, if the bank rate rises, individuals and firms financing operations with borrowed money from banks tend to sell their securities and use the proceeds to pay off the bank. This pressure to sell the securities is followed by a decline in demand for them, and prices are, therefore, further depressed. They now begin to invest their surplus funds in deposits instead of securities. Prices going down means that the yield rises; for example, when the price is 100 a 4% dividend means a yield of 4%, when price falls to 80, the yield becomes 5% and since the yield on old securities must be rivalled by

any one wanting to borrow for a long term the effective long term rate of interest has risen.

Besides this effect in the securities market, to make its rate effective the central bank will change the supply of money. A higher bank rate implies some reduction in the total of bank cash which the central bank may allow to result from a loss of gold or may produce by selling securities. This will lead to a contraction of their more liquid assets by the commercial banks, and if the conditions persist for a long time these banks will attempt to restore their customary proportion of liquid assets by parting with some of the less liquid ones. That is to say, advances and investments tend to decline. And as advances are the most remunerative assets, the bankers usually sell long term gilt-edged securities which may bring about a rise in long term interest rates. Conversely, if the central bank pursues a policy of cheap money, it enlarges the cash basis of the banks which add to their investments and this buying of gilt-edged securities strengthens the market for them and long term interest rates tend to drop. Thus, in any prolonged change of the bank rate the operations of the commercial banks are likely to intensify the effects of public's operations in the securities markets. Hence, this transfer of funds from the short term to the long term market makes the two rates move towards each other, and the period for which they will behave like this, depends on the public's view of the future of the interest rate.

The movement in the long term rate affects the willingness of entrepreneurs to hold fixed

capital goods, for example, factories, machines, railways, ships, aeroplanes etc. A capital extension programme depends upon a number of factors—technical and economic. Here the latter alone is to be discussed. Given all the technical factors and the entrepreneur's estimate of the receipts, the extension will depend upon the effective rate of interest at which loans can be obtained for the purpose. The lower the rate of interest, the more likely is the entrepreneur to decide that the extension is worth undertaking; the higher the rate of interest, the less attractive is any form of capital extension. The same principle holds good in case of worn out fixed capital also. Thus, it is clear that the effective rate of long term interest is one of the crucial factors in determining the capital extension or replacement. Other things being equal, a fall in the rate of interest will stimulate capital development which will lead to increased employment of other factors of production Production will increase and money incomes would also rise, which will also increase savings and expenditure on consumption goods. The results, in short, will be the same as in case of inflation of currency. When the rate of interest rises then the phenomena of deflation of currency appear. The efficacy of this long-term rate like that of the short term will depend upon the elasticity of demand for capital. The more elastic the demand, the more effective the rate of interest. Hence to conclude, bank rate influences the general level of prices through disequilibrium in the capital market.

To sum up:—Bank rate is the official

advertised minimum rate of discount at which the central bank discounts approved bills of exchange and makes advances for short terms on marketable securities. It is fixed every week by the Central Board of management, is usually higher than the market rate, and regulates all other rates in the money market. It is the most effective weapon in the hands of the central bank to safeguard its Gold and Specie Reserves, so that its financial stability, and through it, the stability of the country as a whole, may not be jeopardised by an excessive depletion of its reserves. The reserves of the central bank are likely to be depleted either by internal demand or by external demands and exports. The internal demand for money is fairly regular and periodic to enable the bank to make the necessary provision to meet them and to maintain its reserves; but the foreign demands are very irregular and more effective in depletion of the reserves. An acute depletion of the reserves may be caused by a general monetary crisis, or by a national credit crisis, when foreign demand for gold and the pressure to encash foreign claims increase, and by a coincidence of internal heavy demand with an external drain of gold resources. The central bank meets such a crisis by raising its rate of discount which causes all other interest rates in the money market to rise and thus results in attracting foreign loanable funds for investment. Thus, gold flows into the country. The banker's deposit rate follows closely changes in the Bank Rate, although it is lower than the latter. A rise in the bank rate leads to a rise in

the deposit rates, and, as the bankers are obliged to pay higher rates to attract deposits, they compensate themselves by charging higher rates of interest on the loans and advances made by them to the bill brokers 'and discount houses for short term. These in turn increase their rate of discounting bills and making advances. The consequence is that rates of interest rise all round in the country. The effectiveness of the bank rate is greater in periods of scarcity on account of its being the lender of last resort. But in periods of cheap money the effectiveness is less and the central bank, to influence the money market at such a time, resorts to its open market operations to reduce the available supplies of money to be loaned out. That is to say, the central bank itself borrows against the security of stocks or bills.

Open Market Operations

Another method in which a Central Bank controls the volume of credit and regulates its creation by the member banks, and in which it maintains the internal and external stability in the value of money, is the Open Market Operations. This system is an emergency measure and is used to make the Bank Rate effective. It is the most powerful weapon in the hands of the Central Bank and has developed during the post-war period. It has introduced a new element of management in the banking and credit policy of a country.

Open market operations indicate the direct dealings of the Central Bank with the market in

respect of buying and selling securities and bills for the purpose of controlling credit and checking undue expansion and contraction of credit for the maintenance of stability in trade and prices. Ordinarily, the Central Bank is prevented, with a view to avoid competition with the member banks, from having direct dealings with the market. It can buy or sell securities and bills only through the member banks. But, if in the interests of a national credit policy, it is essential to regulate the creation or contraction of credit, then the Bank is permitted by its charter to buy or sell bills and securities openly and directly in the market with a view to expand or contract credit. If the creation of credit by member banks is going on rapidly and the Bank wants to reduce its volume, then it sells bills or securities voluntarily until the Bank Rate becomes effective. The purchasers of these bills and securities pay the Central Bank by cheques and drafts on the commercial or member banks and thus the reserves of the member banks with the Central Bank are reduced. Their resources are transferred to the Central Bank and the reduction in the resources of the member banks curtails their power of creating further credit; "for cash to a commercial bank is the base on which an inverted pyramid of credit is raised to several times its volume. A diminution of available cash supplies, *therefore, quickly forces a policy of credit restriction on the commercial banks*."* On the other hand, if there is a deficiency of credit and stringency in the money market because

* *Kisch and Elkin: Central Banks*, p. 108.

the reserves of the commercial banks are small and therefore they are not able to create a sufficient volume of credit, then the Central Bank begins to buy bills and securities. The sellers are paid by the Central Bank and they deposit their cash with the commercial banks whose cash resources are thus increased. Now they are able to create more credit and the stringency is relieved. Thus, through the open market operations, the Central Bank can increase or decrease the reserves of the commercial banks and control the volume of credit. This is the easiest and the quickest method by which the Central Bank can relieve a sudden deficiency of credit and can prevent its occurrence by taking anticipatory action. The Bank Rate and the Open Market Operations are in fact complementary. Of these two weapons of control and regulation of credit, the open market operations are more effective because they "produce a direct effect on the reserves of the member banks and hence on the volume of deposits and credit generally, by their immediate consequences and apart from their indirect reaction."*

"While open market operations might be sought as an instrument to influence both short and long term rates of interest, the bank rate gives the central bank direct contact with short rates and the money-market. The effectiveness of this contact and the speed with which it is able to effect the credit-structure are a measure largely of the organised and well-knit character of the market."†

* *Keynes : A Treatise on Money : Vol. II, p. 251-52.*

† *Muranjan : Modern Banking in India, p. 263.*

The control of the central bank over the money market depends on the funds of the money market itself and on bank loans on the one hand, and on the frequency of rediscounts or loans from central bank to member banks on the other. In India there is a paucity of bills and the banks have no control of the local bill-market, while "rediscounts and loans to scheduled banks hardly exist." The bank rate depends for its effectiveness on its level and on the liberality or narrowness of rediscounting of eligible bills and notes. There is a wide disparity in interest rates, the bazar bill rate being the highest in the Indian money-market; and it is difficult for the Reserve Bank to maintain an effective contact with a variety of rates all over the country. The abundance of funds and cheap rates so far have enabled the Bank to maintain the uniform minimum rate of 3% since 28th November 1935. The effectiveness or otherwise of the bank rate depends on the initiative of the scheduled banks, but in open market operations the Reserve Bank acts on its own initiative. "Open market operations may be used either to supplement the effectiveness of the bank rate or independently, within moderate limits, to narrow the gap between bank rate and market rates, to induce banks to move in step, to avoid the psychological difficulties of changes in the bank-rate etc. On account of the character of the assets employed to carry out these operations, the Reserve Bank has in them a direct means to influence the long term rate also.

"The extent and effectiveness of open market

operations depend on three conditions, the size of the resources which the Reserve Bank can muster for the purpose, the quality and volume of the assets it is permitted to deal in or hold, the capacity and organisation of the market in which they have to be carried out."*

CHAPTER XVII

RESERVE BANK OF INDIA

Introductory:—The question of a Central Bank for India has been agitating the mind of the Indian public ever since 1835, but it was only a century later *i. e.*, in 1935 that the Reserve Bank of India was established on the 1st of April. The Chamberlain Commission of 1913-14 did not consider the question of the establishment of a Central Bank for the country, but a prominent member of that Commission, Mr. J. M. Keynes submitted a very comprehensive memorandum in which he envisaged a state-owned and state-managed central bank with a monopoly of note issue, the privilege of handling the government balances, the management of the public debt and service as a bankers' bank, but the Government took no action on it. When the Great War broke out it left the Indian banking system completely disorganised. The Babington Smith Committee of

*Muranjan: op. cit. p. 268-69.

1919 did not make any recommendation with regard to a central bank. But the War did bring home to the Government of India the necessity of a central bank and, as a result of this, an Act was passed in 1920 whereby the three Presidency Banks were amalgamated together under the name of the Imperial Bank of India which began to function on the 27th of January, 1921. However, it was not a full-fledged central bank; firstly because it had no right of note issue; secondly, because it had no effective control over credit; thirdly, because it was not a bankers' bank providing them with rediscounting facilities; and fourthly, because it was forbidden from carrying on foreign exchange business. Still it was given the semblance of a central bank in that it was entrusted with the handling of government balances and the management of the Indian public debt. The Hilton Young Commission of 1925-26 recommended strongly the establishment of a Reserve Bank of India at as early a date as possible. On 25th January 1927 the Finance Member introduced a bill to give effect to this recommendation but it was dropped for constitutional reasons. The Government appointed a Committee when the Indian Round Table Conference met in London. As a matter of fact the establishment of a Reserve Bank of India was made a condition precedent to the inauguration of the New Constitution by the white Paper in 1933. The Reserve Bank of India Act was accordingly passed by the Indian Legislative Assembly and received the assent of the Governor-General on 6th March, 1934, and the Bank began

to function from 1st April, 1935. From this date it took over the management of the Indian Currency Department by creating a special department of its own known as the Issue Department. The assets of the Gold Standard Reserve were transferred to it and were combined with the Paper Currency Reserve as recommended by the Hilton Young Commission. On the Same date it took over the management of Government a/cs., Public Debt Office and the clearing houses from the Imperial Bank of India. On 3rd April it began the purchase of sterling and on the 16th sale of Treasury Bills. From 1st July, 1935, the Banking Department also began to function and the first Bank Rate was declared @ 3½% on 4th July, and the Scheduled Banks deposited on 5th July, the required percentages of their time and demand liabilities. In April 1936, the Bank opened an office in London to conduct the management of the rupee debt enfaced on London and of the a/cs. of the High Commissioner.

Share Capital:—The Bank is a shareholders' bank. The share capital of the Bank is 5 crores of rupees divided into shares of Rs. 100 each fully paid up. Excepting shares worth Rupees two lakhs and twenty thousands held by the Central Government for disposal at par to Directors of the Central Board for minimum share qualification, the entire share capital is owned by shareholders. The bank maintains five share registers at its offices at Bombay, Calcutta, Delhi, Madras and

Rangoon.* The share capital among these five share registers has been assigned as follows ;—

Bombay	140	lacs of	rupees
Calcutta	145	,,	,,
Delhi	115	,,	,,
Madras	70	,,	,,
Rangoon*	30	,,	,,

Distribution of Shares :

Areas	No. of shares 30th June 41	No. of shareholders 30th June 41	No. of shares 30th June 42	No. of shareholders 30th June 42
Bombay	2,12,823	19,072	2,18,649	18,441
Calcutta	1,21,501	12,246	1,19,941	11,647
Delhi	87,168	12,813	85 762	12,181
Madras	59,826	7,973	58,810	7,697
Rangoon	18,682	1,364	16,838	1,205
Total	5,00,000	53,468	5,00,000	51,171

The average number of shares held by each shareholder was 9·4 on 30th June '41 and 9·8 on 30th June '42. The decline in the number of shareholders, the increase in the average number of shares held by each shareholder and the expansion

**Owing to the Japanese war in Burma, the Rangoon office was removed to Bombay in May 1942 and two temporary offices were opened at Allahabad and Akola during 1941–42.*

of the number of shares on the Bombay register at the expense of other areas as in previous years show the unmistakable tendency of concentration of shares in the hands of bigger capitalists. On the influx of evacuees from Burma into India special arrangements were made for transfer of shares from the Burma to other registers in India.

The Reserve Fund also consists of 5 crores of rupees and is provided by the Government of India in form of government rupee securities. It has got one branch in London and 3 more offices in India at Cawnpore, Karachi and Lahore, where the work of the Issue Department and that concerning the accounts of Scheduled Banks Clearing-House is done.

Management :—The general superintendence and direction of the affairs and the business of the Bank is entrusted to a Central Board of Directors, which exercises all powers and does all acts and things which may be exercised and done by the bank. The Board is composed of :—

(*a*) A Governor and two Deputy Governors appointed by the Governor-General-in-Council on the recommendations of the Central Board ;

(*b*) Four directors nominated by the Governor-General in Council ;

(*c*) Eight directors elected on behalf of the shareholders under the various registers in the manner provided in Section 9 of the Act and in the following numbers :

1. Bombay 2		4. Madras
2. Calcutta 2		5. Rangoon
3. Delhi 1		

(*d*) One government official nominated by the Governor-General-in-Council.

The Governor and the Deputy Governors are the executive heads of the bank and hold offices for such term not exceeding five years as the Governor-General-in Council may fix when appointing them, and are eligible for reappointment. Besides the Central Board of Management a Local Board is constituted for each of the five areas and consists of (a) five elected members from among the shareholders of that area who are qualified to vote and (b) three nominated members from the shareholders of that very area who may be nominated at any time by the Central Board to secure representation of territorial or economic interests and particularly of agriculture and co-operation. The Local Boards advise the C. B. and perform duties delegated to them by the C. B.

Organisation :—The bank is organised into two departments like the Bank of England—the Banking Department and the Issue Department; and the functions of both are coordinated by it. The Issue Department is concerned with the issue of bank notes and their management and the carrying on of business incidental thereto. The Banking Department is concerned with the ordinary and central banking functions.

The Central Office of the Bank, now permanently situated in Bombay, is divided into four sections: the Secretary's section, the Chief

Accountants' section, the Agricultural Credit Department and the Exchange Control Department.

There are seven offices and branches of the Issue Department at Bombay, Calcutta, Madras, Rangoon, Karachi, Cawnpore and Lahore. Each branch is divided into two separate departments: the Treasurer's Department, subdivided into the Issue and the Exchange branches; and the General Department, subdivided into the Registration, the Cancelled Note Verification, the Cancelled Note Vault, the Claims, the Accounts, the Records, the Internal Audit and the Resource Branches.

There are five offices of the Banking Department at Bombay, Calcutta, Madras, Delhi and Rangoon and branches at Lahore, Cawnpore and Karachi under the charge of the currency officer. These branches do not perform Govt. treasury business, but those at Karachi and Lahore have undertaken since 1940 the management of local clearing houses and opening of accounts for the scheduled banks. The Banking Department at each office is in charge of a Manager and is divided into the Share Transfer, the Deposit Accounts, the Securities, the Public Accounts and the Public Debt Departments.

Functions and Business of the Bank

The Bank is authorised to carry on the following general business :—

1: The accepting of money on deposit without interest from, and collection of money for, Secretary of State, Central and

Provincial Governments, States, banks and Local authorities.

2. The purchase, sale and rediscount of bills of exchange and pro-notes with certain restrictions.

3. Making of loans and advances repayable on demand but not exceeding 90 days against the security of stocks, funds and securities (other than immovable property) against gold coin or bullion or documents of title to the same, and against such bills of exchange and promissory notes as are eligible for purchase or rediscount by the bank.

4. The purchase from, and sale to, scheduled banks of sterling in amounts of not less than one lakh of rupees.

5. The making of advances to the Governor-General-in-Council and to the Local Governments repayable in each case not later than three months from the date of making the advances.

6. The purchase and sale of Government securities of the United Kingdom maturing within 10 years from the date of such purchase.

7. The purchase and sale of such securities of the Government of India or Local Government of any maturity or of a Local authority in British India or of certain specified Indian states.

8. Issue of demand drafts made payable at

its own offices or agencies and making, issuing, and circulation of bank post bills.

9. The purchase and sale of gold coin and bullion.

10. Acting as agent for the Secretary of State in Council, Governor-General-in-Council Local Government, Indian State, or Local authority for the purchase and sale of gold and silver, for purchase and sale, transfer and custody of bills and exchange, securities or shares in any company, for the collection of the proceeds whether principal, interest, or dividends of any securities or shares, for the remittance of such proceeds at the risk of the principal by bills of exchange payable either in India or elsewhere, for the management of the public debt.

11. The sale and realisation of all property whether movable or immovable which may come in the possession of the bank in satisfaction of its claims.

12. The opening of an account with or making of an agency agreement with, and the acting as agent or correspondent of, any bank which is the principal currency authority of any country, or any international bank formed by such banks and the investing of the funds of the bank in the shares of any such international bank.

13. The borrowing of money for a period not exceeding one month for the business of

the bank only from a scheduled bank in India and a central bank outside India not, exceeding the amount of the share capital in case of Indian borrowings and the giving of security for money so borrowed.

14. The making and issue of bank notes subject to the provisions of the Act.

15. Generally the doing of all such matters and things as may be incidental or consequential upon the exercise of its power or the discharge of its duties under the Act.

Emergency Business or Open Market operations :—If in the opinion of the Central Board or of any delegated authority or the Governor, it is necessary, to regulate credit in the interest of Indian trade, commerce, industry and agriculture, the bank may, notwithstanding any limitations contained in the above sections, purchase, sell or discount in the open market any bills of exchange or pro-notes, though such bills or notes do not bear signatures of scheduled banks or a provincial co-operative bank, purchase or sell sterling in amounts of not less than the equivalent of one lakh of rupees; make loans or advances on the security of such bills of exchange or promissory notes as are specified in the corresponding sections, repayable on demand or on the expiry of 90 days, provided the action is taken by the governor or the delegated authority except in cases of special urgency, with consultation of the Central Board.

Forbidden Business:

1. The bank may not engage in trade or otherwise have an interest directly in any commercial, industrial or any other undertaking except such interest as it acquires in the course of the satisfaction of its claims and that such interest is disposed of at the earliest possible moment;
2. The bank may not purchase its own shares or the shares of any other bank or of any company or grant loans upon the security of any such shares.
3. May not make unsecured loans or advances.
4. May not draw or accept bills payable otherwise than on demand.
5. May not allow interest on deposits or current accounts.
6. May not advance money on mortgage of, or otherwise on the security of, immovable property or documents of title relating thereto, or become the owner of immovable property, except for its own business premises and residences for its officers and servants.

Obligation to buy and sell sterling: The bank shall sell to or buy from any person who makes a demand in that behalf at its office in Bombay, Calcutta, Delhi, Madras, or Rangoon, sterling for immediate delivery in London at a rate not lower than 1s. $5\frac{49}{64}$ d. to the rupee and not higher than 1s. $6\frac{3}{16}$ d. per rupee respectively provided

that no person shall be entitled to demand to buy or sell an amount of sterling less than £10,000

Cash Reserves of the Scheduled Banks : Every bank with a capital and reserve of five lakhs of rupees each is required to keep with the Bank a balance equal to 5% of its demand liabilities and 2% of its time liabilities (excluding share capital, reserve, P/L A/c. Balance and any loan from the Reserve Bank), and if the balance any day falls short of this required minimum then the defaulting bank is required to pay a penal interest at the rate of three per cent in addition to the Bank Rate on the amount by which the balance is shorter than the prescribed minimum for the first week and 5% above the Bank Rate afterwards.

Allocation of Profits :— After payment of a 5 per cent dividend out of the net annual profits a small proportion of the surplus is to be allocated to the payment of an additional dividend to the shareholders and the balance is to be handed over to the Governor-General-in-Council.

The profits or gains of the bank are exempt from liability to income tax or super tax but the shareholders of the bank are liable.

Agricultural Credit Department :—The Bank has created a special Agricultural Credit Department with a view to maintain an expert staff to study all questions of agricultural credit and to co-ordinate the services of the Bank in connection with it with provincial co-operative banks and other banks or organisations engaged in the business of supplying agricultural credit.

The Bank was required to submit at the earliest possible time or within 3 years of its inauguration, a Report with its proposals for legislation on the improvement of the machinery dealing with agricultural finance and methods and for effecting a closer connection between agricultural enterprise and the operations of the Bank. Accordingly, the Bank submitted a preliminary report in 1936 to the Government of India and this was followed by the Statutory Report of 1937. The Bank indicated the various directions in which improvements were to be made to make the co-operative society more serviceable to the agriculturists It laid great emphasis on the development of multi-purpose co-operative societies instead of pure credit societies to effect an all round improvement in the villages and in the economic, social, cultural and sanitary conditions of the cultivators. As regards its own assistance to the agriculturists, the Bank expressed its inability to make any fundamental changes in the existing credit facilities of the cultivators, until they were made creditworthy. For this object it suggested measures to wipe out ancestral rural debts through conciliation and legislation and the development of land-mortgage banks, to regulate money-lending through registration, to improve the organisation of marketing and financing of agricultural produce, to increase their earning capacity and purchasing power and raise their standard of living.

The *Central Banking Functions* of the Bank as provided by the Act are :—

(a) Acting as agent to Secretary of State

Government of India, Provincial Governments for accepting and paying money on their behalf and carrying out exchange, remittance, and other banking operations and managing the public debt. These bodies must entrust their money, remittance, exchange and banking transactions to the bank and deposit free of interest all their cash balances with it.

(b) The Bank has the sole right of note issue (For a detailed discussion of this function see the chapter on Indian Paper Currency.)

(c) Buying and selling of sterling in amounts of not less than £10,000.

(d) Receiving of deposits of 5% and 2% of the demand and time liabilities of banks with a capital and reserve of Rs. 5 lakhs (called scheduled banks) and providing rediscounting facilities to them. There were 54 scheduled banks in 1937 and 59 in 1940-42.

"Apart from the fundamental central banking functions mentioned above, the Bank performs a number of subsidiary or ancillary functions incidental to its position as the apex bank of the country such as the supplying of different forms of currency, the extension of remittance facilities, the management of the clearing houses, the rendering of advice on financial matters, collection and dissemination of banking statistics etc."* The

Functions and working of the Reserve Bank of India 1941

Bank keeps adequate stocks of notes and coins to meet Government requirements and provide remittance facilities to the public at the Government treasuries and sub-treasuries and at its branches, offices and agencies. For this purpose the branches of the Imperial Bank and Government treasuries having currency chest facilities and numbering 1,300 are regarded as the agencies of the Bank.

There has been a considerable expansion in the activities of the banking Department since the present war. In addition to the opening of the Exchange Control Department for regulating foreign exchange transactions and export and import, the Bombay office of the Bank since December 1939 has been selling silver on behalf of the Central Government. The Bank has introduced a scheme for the licensing of silver imports on a profit-sharing basis and fixed the maximum and minimum prices for imported silver.

The Bank has paid a dividend of 3½% per annum up to 30th June, 1942 and since its inception to the 30th June, 1940 it has paid Rs. 1·33 crores to the Central Government. For the year ending 30th June, 1942 it has paid over 3·24 crores of surplus profits to the Government and this figure exceeds that of the last year by 62·27 lakhs. It shows that the addition to securities in the wake of additions to note issue is profitable to the Government rather than the Bank and the contribution for the next year is likely to be larger than that of the year ending June 1942.

The consolidated statement of the Scheduled

Banks prepared from their weekly returns contains the following items :—

(In lakhs of Rupees)

	27-6-41	26-6-42*
Demand Liabilities :		
India	183,94	267,15
Burma	10,95	
Time Liabilities :		
India	103,34	97,30
Burma	4,05	
Cash : (Notes, rupees & subsidiary coins)		
India	11,38	14,52
Burma	65	
Balances with the Reserve Bank :		
in India	29,66	60,93
Advances :		
India	122,15	94,30
Burma	5,65	
Bills discounted :		
India	5,35	1,47
Burma	7	

Critical Examination of Reserve Bank

A perusal of the provisions of the Reserve Bank Act 1934 brings out clearly the salient

**Since Feb. 1942, the figures for Burma have been omitted.*

features of its organisation, management, functions, liabilities and privileges and shows further that the Bank satisfies the canons of sound central banking operations. As pointed out in the last chapter, a central bank is an institution which acts as the sole supplier of currency and credit to the various banking and credit agencies in the country, it is a bankers' bank, a government bank, and it controls the currency and credit in such a manner as to be able to maintain the stability of the currency both internally and externally. It was further pointed out there that the distinguishing features of a central bank are *firstly*, that service to community and not profit-making is its goal, *secondly*, that it does not compete with the other commercial banks, and *thirdly* that it is subordinate to the State. The provisions of the Reserve Bank Act satisfy all these canons. The commercial banks of the country are controlled by the provision that 5% and 2% of their time and demand liabilities must be deposited by them with the Reserve Bank which is prevented form competing with other banks by the provision that it can not accept deposits form the ordinary public but only from Governments and that too without interest, that it cannot grant loans or advances to the public directly on the security of movable or immovable securities, that it cannot purchase or discount promissory notes and bills of exchange without the signature of a scheduled bank on them. The supply of currency and credit is done through the issue of notes and elasticity is secured through the open market operations and rediscounting of genuine commercial papers of the

scheduled banks and the issue of emergency currency as provided in the Act. Through its bank rate it is expected that the bank shall be able to control effectively the money market and co-ordinate the services of the various banking and credit agencies. The Governor-General-in-Council has great powers of control and supervision over the bank. It acts as Government banker for remittances and handles government balances and manages the public debt and in lieu of these privileges pays its surplus net profits to the Government. Through the provision of rediscounting facilities and of loans and advances on the security of collaterals to the various scheduled banks it acts as a bankers' bank and as 'the lender of last resort'. It pools together the monetary resources of the country and directs them into productive channels.

How far the Reserve Bank of India has succeeded in removing the defects of the Indian Money Market : The Indian banking system as it developed before was characterised by lack of systematic organisation. In fact it is a misnomer to call it a system. There had been an utter lack of co-operation among the various financing and credit agencies in the country and of co-ordination among the constituents of the Indian Money Market. Banking, currency and exchange were controlled, monopolised and manipulated by the Government of India without adequate regard to the needs of the business community. The right of note issue had been denied to the Presidency Banks and the joint stock banks had been prevented from carrying on foreign exchange business which has

been the exclusive preserve of the exchange banks. This loose organisation had been due to the absence of a central bank functioning as a co-ordinating agency, as a government bank and as a bankers' bank. The inelasticity of currency and credit due to a divorce between the two and leading to monetary stringency during the busy season had been accentuated by a lack of rediscounting facilities and a well developed bill market. The financing of trade and industry had not been based on a sound footing.

When the Reserve Bank of India was established in 1935 it was expected to serve as a full fledged central bank. It was entrusted with the management of the currency department, the government balances and their remittance business and with the public debt of the Government of India in that very year and of the autonomous Provincial Governments, since 1st April 1937. Thus, it functions as a government bank. Then it has been granted the monopoly of note issue and Gold Standard Reserve and the Paper Currency Reserves have been transferred to it. The scheduled banks with a capital and reserve of 5 lakhs each deposited on 5th July, 1935 their reserves of 5% and 2% of their time and demand liabilities respectively, and thus they are controlled by the Reserve Bank which apparently acts as a bankers' bank. But the reports of the first two years of its working have amply shown that it has failed to function as a full-fledged central bank controlling effectively currency, exchange, banking and credit policy of the country. An examination of

the various statements and schedules published by the bank leads to the inevitable conclusion that it has not functioned as a full-fledged bankers' bank. The truth of this statement can be verified from the following facts :—

(*i*) The bank rate has not been effective in controlling the money market of India because there is a divergence between the bank rate and the Bazar Bill Rate. The former remained at $3\frac{1}{2}\%$ from 4th July to 28th November 1935 and then it has been steady at 3% from November 28, 1935 to the present day The same has been the tendency of the Imperial Bank Hundi Rate; but the Bazar Bill Rate in Calcutta had been 7·8% for three months from April to June 1935, and then 5 6% upto March 1937 with only two exceptions in July 1935 and December 1935 when it was 6·5%; whereas the Bazar Bill Rate in Bombay had shown wider fluctuations; it had varied between 3% and $6\frac{3}{4}\%$

(*ii*) It has failed to develop an organised bill market to provide rediscounting facilities to the scheduled banks as provided by the R. B. Act, 1934. The rediscounting of bills has been only a paltry thing.

(*iii*) It has failed to control and co-ordinate the services of the various credit agencies and the co-operative societies and indigenous bankers lie still outside its purview and supervision.

(iv) It has failed to bring the credit agencies providing agricultural finance into its effective control.

(v) It has failed to pool together the reserves of the various institutions into a central reserve because, excepting the member banks and such other co-operative banks and indigenous bankers as are on its approved list, the majority of the small banks and credit institutions have no direct connection or link with it.

(vi) The art of central banking consists of holding a balance between the stability of internal price level and the stability of the foreign exchange. Judged by the statistics of prices and exchange and the figures of export and import trade the working of the Bank has shown a recovery of agricultural prices. But unfortunately the question of exchange is still out of the hands of the Bank and it has been manipulated since September 1931 by the Viceroy in his discretion or according to dictation from Whitehall. The delinking of the rupee from gold and its linking with sterling at 1s. 6d. has caused the internal price structure to fluctuate in sympathy with the sterling value of the rupee which is governed by causes other than economic.

However, the Bank has very successfully floated government loans at cheap rates, has provided remittance to Secretary of State, sold Treasury

Bills, and helped in maintaining the rupee. At its instance important changes have been made in the Indian Company's Law relating to banks. It has provided cheap inland remittance facilities to the banks and has helped in lowering the money rates. It has also helped indirectly the development of banking facilities. The Bank has been working only for ten years now and it is expected that gradually the existing defects will be removed.

Elasticity of Currency and Credit and the Reserve Bank

One of the fundamental principles of a sound currency and credit system is that the currency must be elastic *i.e.* it must be capable of expansion and contraction according to the needs of the business community. The Indian currency and credit system as it obtained before the establishment of the R. B. suffered from an acute inelasticity. The currency was monopolised by the Government of India and the credit was controlled as far as possible by the Imperial Bank of India. It acted as a government bank and to some extent a bankers' bank without having the right of note issue. This resulted in the government practically predominating in the bank rate in the money market. This diarchy or dual control resulted, as pointed out by the C. B. I. Committee, in "a serious lack of elasticity and stability of monetary conditions." Under these circumstances, the range of interest rates in India was wider than other countries varying as it did from 3% in the slack season to 7 or 8% in busy season. It was supposed to be an axiom.' The seasonal monetary

stringency was inevitable and responsible for the wide range of interest rates.

India is predominantly an agricultural country: about 73% of the population directly depends on agriculture. This fact in the economic situation of the country divides the year into two seasons; a busy and the other slack. The busy season usually occurs in the spring and the summer, and at this very time the exportable surplus of primary products is to be financed and mobilised. It synchronises with the marriage season as well, and the payment of land revenue also falls in this season. During this busy period an enormous quantity of cash is necessitated and unfortunately it was usual in this period that the government was unable to supply increased quantity of money in circulation. In other words, at a time when the requirements of business demanded an expansion of currency, there was a monetary stringency, whereas in the slack season, when there was no demand from business for money, there was usually a plethora of funds resulting in cheap money rates. The situation was further aggravated by an utter lack of an organised money market, a well developed bill market with rediscounting facilities, and the absence of a central bank of issue co-ordinating the currency and credit policy, and making suitable adjustments to the changed requirements of business.

As pointed out by the Central Banking Enquiry Committee the main task of a properly managed and well-organised Reserve Bank is to tide over busy periods when the money is in strong

demand without unduly raising the bank rate. The Reserve Bank by expanding credit can meet the seasonal demand for money and dispense with the seasonal monetary stringency and wide variations in bank rate. When the Imperial Bank of India came into existence in 1921, to remove this seasonal stringency and to make the currency elastic the government undertook to loan 12 crores of rupees to it against 90 days' first class bills. No issue was to be made until the bank rate rose to 6 per cent. The loan carried interest at a minimum rate of 6 per cent for the first 4 crores and 7 per cent for the next 8 crores. This fixing of arbitrary rates for the issue of additional currency unnecessarily penalised trade and commerce. This system of issuing emergency currency at stable rates had not been able to remove the inelasticity of the currency system. The Reserve Bank of India keeps sufficient cash in reserve in the slack season to supply the needed currency in the busy season at reasonable rates. The Bank provides emergency currency by rediscounting approved bills of exchange, and by granting advances on approved promissory notes of commercial banks and thus provides the necessary elasticity to the currency system which is the *sine qua non* of a sound and stable monetary system. Inequality of the rates of interest in the different money markets of India is removed by transfer of money from place to place. The credit expansion suitable both in point of time and degree and the regulation of gold movements are all desirable changes which the Reserve Bank has been able to achieve

as a central bank of issue. The elasticity of currency and credit has been secured by requiring the Bank to do among others the following important businesses which lead to an expansion of credit:

(*i*) purchase, sale and rediscount of B/E and P/N drawn and payable in India arising out of *bona fide* commercial or trade transactions bearing two or more good signatures one of which must be that of a scheduled bank and maturing within 90 days from the date of such purchase, sale or discount.

(*ii*) purchase, sale and rediscount of B/E and other commercial paper which must be endorsed by a scheduled bank which is drawn to finance seasonal agricultural operations or the marketing of crops and maturing within 9 months.

(*iii*) purchase, sale and rediscount of commercial paper bearing the signature of a scheduled bank and issued for trading in securities of the Government of India, Local Governments, or of certain states maturing within 90 days.

(*iv*) purchase, sale and rediscount of B/E. including treasury bills drawn on or in any place in the U. K. and maturing within 90 days from the date of purchase, provided that transactions are carried on only with the scheduled banks.

(*v*) issue of demand drafts made payable at its own offices or agencies.

(*vi*) making loans or advances against stock, funds, bullion, bills of exchange, and Promissory notes, to States in India, Local Authorities, scheduled banks, and Provincial Co-operative Banks for not more than 90 days.

But the greatest provision for securing elasticity of currency and credit is the right of the bank to make and issue notes on the proportional reserve method and its powers to issue emergency currency and to carry on open market operations.

The increase in the assets of the Issue Department and the issue of equivalent notes from it to the Banking Department causes an expansion of currency, while the withdrawal of notes from circulation and the consequent reduction in the assets of the Issue Department causes a contraction of currency. "When the cash balance of the Banking Department requires replenishment, the Bank resorts to expansion of currency and transfers notes from the Issue to the Banking Department according to its requirements. When the Government finds its balance in excess of its normal requirements, it reduces its debt obligations and the Bank cancels *ad hoc* treasury bills held in the Issue Department against contraction of currency." Rupee or sterling securities or both are transferred thus from the Banking to Issue Department or *ad hoc* treasury bills are created to increase the assets of the Issue Department and this secures

RESERVE BANK OF INDIA

Issue Department: Liabilities (*In lakhs of rupees*)

	1935	1936	1937	1938	1939	1910	1912
	Dec	Dec	Dec.	Dec	Dec	Dec	June
Notes held in the Banking Department ..	21 40	11,87	29,33	18,44	17,67	13 91	11,33
Notes in circulation	1,77,78	1,91 99	1,85,37	1,88,00	2,36 63	2,41, 5	4,47 23

Assets

	1935	1936	1937	1938	1939	1940	1912
	Dec	Dec	Dec	Dec.	Dec	Dec.	June
Gold coin and Bullion	44 42	44,42	44,41	44,42	44,42	44,42	44,42
Sterling securities	66,19	71,31	80,31	59,50	1 07,60	1,31,60	2,66,85
Rupee Coin	57,12	64,76	62 56	70 19	64,04	29,46	28,00
Govt. Rupee Securities	25 64	23,37	27 41	32 32	38,34	49 61	1,22,27
Ratio of gold and sterling to notes ...	67 23	56 77	58 09	50 34	59 74	65 93	67 14

BANKING DEPARTMENT

Liabilities

(*In lakhs of rupees*)

	1935	1936	1937	1938	1939	1940	1942
	Dec.	Dec	Dec	Dec	Dec.	Dec	June
Paid up capital and Reserve fund	10,00	10,00	10,00	10,00	10,00	10,00	10,00
Govt. Deposits : Central ...	6,05	7,14	9,76	4,87	6,73	10,60	14,11
Other	...	...	...	4,36	4,58	3,60	7,56
Burma	...	...	...	1,95	1,54	2,23	34
Bank Deposits	28,34	15,87	20,16	12,18	18,87	47,93	64,63
Others	26	27	1,27	84	1,16	1,43	2,01
Bills Payable	11	9	12	9	9	69	3,33
Other Liabilities	71	70	56	87	54	2,73	2,38
Assets							
Cash	21,57	11,97	29,11	18,54	17,74	14,05	14,44
Govt. Treasury Bills discounted ...	...	...	...	8,26	10,11	...	6,23
Balances held abroad	17,39	14,86	3,64	1,14	6,98	57,15	80,39
Loans & advances to Govts. ...	1,00	...	2,00	1,06	1,20	3	...
Other loans etc.	...	...	2	11	...	5	...
Investments	5,29	6,16	6,24	5,26	6,42	6,71	8,24
Other Assets	22	1,08	56	79	1,06	1,16	1,23

expansion. In contraction the process of transfer is reversed and *ad hoc* securities are cancelled. The receipt of rupee coin and one rupee notes by the Issue Department from the Government in 1940 led to expansion of currency.

CHAPTER XVIII

THE GREAT WAR AND ITS EFFECTS ON INDIAN BANKING

When the War broke out the Indian Banking System was very loosely organised. In fact to call it a system at all was a misnomer. The various institutions carrying on the business of banking constituted separate entities; there was no co-operation and co-ordination between them. There was no Central Bank controlling the currency and credit policies which were divorced from each other by government monopoly of currency and exchange. Therefore the system suffered from an extreme decentralisation of the national reserves which could not be pooled together in times of emergency. A Central Bank, providing the discounting facilities to other banks, acting as a guide, friend and philosopher to them, and directing the loanable funds into productive channels, was conspicuous by its absence. There was an utter lack of the habit of thrift and banking. There were a number of bank failures just preceding the War in 1913 which had deterred the people

from entrusting their surplus funds to banks and bankers.

Mismanagement, nepotism, and ignorance of the rudimentary principles of banking and the financing of long term credit with short-term deposits were the most important causes of these failures. The clock of progress was therefore set back and under the stress and strain of the war the system completely broke down.

The first effect of the War was a loss of public confidence, which, having been engendered by the banking failures of the preceding year, was strengthened by war. This feeling of distrust which bordered on a panicky attitude led to the withdrawal of deposits from the Indian managed joint stock banks. This withdrawal of deposits caused paucity of loanable funds and hence a contraction of credit. The money market was completely disorganised and demoralised. This had its own consequences on the mobilisation of the harvested crops to the collecting and distributing centres There was an abnormal bank failure between 1913 and 1917, 87 banks went into liquidation and 34% of the total capital of joint-stock banks was lost. Speculative dealings were very much resorted to by these banks and very often they employed their funds in the most hazardous enterprises. Large sums were locked up in speculative dealings in silver, pearls and other commodities; long term businesses were financed without an efficient and adequate investigation into their soundness on the chance of earning large profits and short term deposits were used for

this purpose ; and too large a proportion of the total available funds were frequently sunk in a single business. Many of the directors and managers had little knowledge either of the principles or of the practice of banking, and some of them resorted even to dishonesty, fraud and criminal mismanagement. Thus they lent the funds of banks of which they were directors or managers to themselves or to concerns in which they were directors or partners; they made away with the assets of the banks by showing in the books debts due to the banks that did not exist. To hide all this mismanagement and fraud the books were left in an incomplete state, not being written upto date, or they were falsely made up; window dressing was freely resorted to in making of the balance sheets; and in a few places dividends were paid out of capital. The cash reserves set up against contingencies were very low—hardly 18% of the liabilities, inadequate to serve their purpose in a country like India, where the banking habit has not become very popular as yet.

One of the striking features of the system, as pointed out above, was a small amount of capital and the relatively large amount of business handled with it. Though it enabled the banks to pay good dividends, yet it was fraught with dangers and was an element of weakness. Their position further weakened during the war because the increase in the amount of business done was hopelessly incompatible with the increase in capital and reserves of the banks. The capital of the Presidency banks and the joint-stock banks remained

the same as before the war, but the reserves of the former slightly diminished while those of the latter slightly increased.

When the first shock of the War was over confidence was gradually restored in the currency and exchange policy of the government, which was reflected in the revival of public confidence in the banks. The abnormal increase in business, caused by the unusual demand of the Indian primary products by the warring nations of the world, led to a rise in prices and the consequent expansion of currency and credit. Hence, the most important feature of the system during the war was a great increase in deposits.

From 1913 to 1918 the deposits of the various banks increased as follows :—

Presidency banks	78%
Joint-Stock Banks	49%
Exchange banks in India	83%

On the whole, the total average deposits of all banks increased by 65%. At the end of 1918 the deposits of the Presidency Banks declined remarkably but those of others increased substantially. Most of this increase, however, was merely an evidence of indebtedness and inflation and not of prosperity, for most of the deposits consisted not of cash paid in, but of credits borrowed. This creation of credits further increased the means of payment and led with the inflation of paper money to an enhancement of prices. The creation of this mass of credit was due to the Government War finance on its own behalf and on behalf of the Home and Allied Governments by raising loans.

and obtaining credit in the form of Treasury bills. The banks had to purchase large amounts of war loans and treasury bills themselves as well as to grant large amounts of credit to their customers to enable them to purchase. These purchases were paid for by means of the grant or transfer of credit to the Government which transferred it to the public by means of payment to contractors, manufacturing firms etc. The result was that the deposits of the banks were increased by the amount of their subscriptions, the Government loans and bills, and by the amount of the credit granted by them to their customers to enable them to make similar purchases.

The increase in the liabilities in the shape of deposits was, however, accompanied by a large increase in cash balances and thus the war considerably strengthened the Indian Banking system till the end of 1917. During the war the banks endeavoured to increase their cash reserves and were enabled to do so by the profits of industries kept with them which in normal times would have been invested in the creation of new enterprises or in the expansion of old enterprises or remitted to London. As to the exchange banks, on occount of the difficulties of obtaining remittances from their head offices and also delay in cables, their branches in India found it necessary to maintain proportionately larger balances and they did so by imports of gold. This accretion to their resources was till the end of 1917 an important factor in the increase of the cash balances of the Presidency banks, with which the exchange banks kept their

deposits. At the end of 1918 the proportion of cash to liabilities declined appreciably in the Presidency banks and the exchange banks, but in case of joint-stock banks, the most vulnerable part of the Indian banking system, this improvement was kept on the whole satisfactorily.

As a result of the increase in deposits the investments of the banks increased considerably:—

Presidency Banks by	142%
Exchange Banks by	137%
Joint Stock Banks by	53%

This was due to the large purchase of Government issues of all kinds by the banks from the outbreak of the war to assist the Government in its war finance. They produced the same effects on the deposits of the banks as the advances made by them.

In discount and advances also there was a great increase in the Presidency banks and joint stock banks but not in the exchange banks, on account of the Government restrictions on the discounting of foreign bills coupled with the currency and exchange difficulties. Thus, on the whole, the Indian banking system did well during the war.

The most important effect of the war, however, and the crisis in banking was the establishment of the Imperial Bank of India with the amalgamation of the three Presidency banks. The war by bringing home to the Government of India the serious maladies from which the banking organism of the country was suffering focussed the

attention of the Government as well as of the public on the necessity of establishing a Central Bank to co-ordinate currency and credit policy, serve as a bankers' bank and a Government Bank.

Another important effect of the war was the establishment of industrial banks to provide industrial finance. The war by limiting the supply of imported manufactures and by causing windfall profits stimulated the development of industries under the able guidance of the 'Indian Munitions Board, and hence, the encouragement to establish industrial banks. The Gwalior Financial Corporation, The Tata Industrial Bank, Karnai and Calcutta Industrial Banks came into existence during this period.

Summary :—the chief effects of the war on banking system may be summarised as follows :—

(*a*) Increase in deposits of all classes of banks which increased from 97·51 crores to 154.97 crores rupees and over.

(*b*) Improvement in cash resources and increased investments.

(*c*) A great increase in the amounts of cheques cleared, the increase was 115% in 1918 over the pre-war figure.

(*d*) A growing disparity between the capitals of the banks and increasing business transacted by them.

(*e*) Stimulation of the growth of industrial banks.

(*f*) Defects of Indian Banking system were

brought out in bold relief and pointed towards the need for a thorough-going reform of the system and the establishment of a Central bank*.

CHAPTER XIX

BANKING CRISIS

Whenever a bank fails it is a very serious matter. A joint stock bank usually deals in public or borrowed money and not in its own money as is done by a private banker; and therefore if such a bank fails the loss does not fall only on the shareholders but the depositors and innocent investors are also ruined. Confidence which is the bedrock of banking is badly shaken and a slight rumour that there is something wrong or rotten in the affairs of a bank does not cause a run upon that particular bank only. There is a general run on all banks: there is a panic and depositors and investors rush to withdraw their funds as quickly as they can. Joint stock banks normally keep a small percentage of their deposits for meeting the day to day demand obligations of their customers and the rest of the funds, instead of lying idle in their vaults, is invested in the financing of agriculture, trade and industry. Theoretically

* *For a detailed account see Panandikar's Economic consequences of the War for India.*

therefore, the position of a bank may be perfectly sound in that the assets are greater than the liabilities, but on account of the sudden on-rush of an unexpectedly large number of depositors to get their money back a bank is not able to satisfy all their demands. The business of the bank is suspended, its doors are closed, shutters drawn, and it has to go into liquidation. But the trouble does not end here. The failure of one bank causes a loss of public confidence in banks in general, and therefore if there is no central bank to come to the rescue of the troubled bank by granting liberal credit and enabling it thus to meet all calls made on it, the failure of one bank develops fast into a general run upon all other banks. Such a grave state of financial and banking conditions is called a banking crisis.

Causes:—It may be due to several causes: economic and otherwise. Mismanagement by the directors of the bank, inexperience, lack of foresight and of judicious investments of funds into easily marketable securities, speculative dealings in the stock and commodity markets; gross negligence of duty and dishonesty by the staff, want of a proper ratio between the cash resources and loaning operations and deposits etc., abnormal circumstances due to war or a political crisis etc. are the usual causes of bank failures and crisis. Frozen credit and lack of liquidity of bank funds are the primary causes of all banking crises.

India had to experience an acute banking crisis from 1913 to 1918, but the failures of banks continued even in 1919 to 1925 and 1926 to 1934;

and the mortality among her joint stock banks in all the three periods was very heavy. True it is that India had a banking crisis in 1829-32, in 1857 and then again in 1863-66 and many banks had failed inflicting heavy losses; but compared to these the banking crisis of 1913-18 was so far unprecedented and most disastrous in its consequences.

From 1905 to 1913 there was a boom in banking development. The period except for 1907-08 was free from famines. There was agricultural prosperity and a large quantity of capital was accumulating. The partition of Bengal in 1905 was followed in its wake by the famous Swadeshi movement which beginning from Bengal gradually overtook the whole country. There was a boom in the growth of banks so much so that the number of banks with a capital and reserve of Rs. 5 lakhs increased from 9 to 18 between 1905-13 with a total paid-up capital and reserve of 4 crores and total deposits of Rs. 22 crores. Besides these bigger banks a mushroom growth of smaller banks had taken place, and although there is no reliable information as to their exact number, it is undoubted that their number was much larger. But this feverish enthusiasm for banking met a rude shock when in 1913 there occurred a banking crisis unprecedented in its magnitude and severity. The banking system, as it existed at the time, suffered from a number of serious maladies which were ultimately responsible for the crisis which overtook the joint stock banks in that year and continued upto 1918 No less than 95 banks

with a paid-up capital of 1,79,80,000 went into liquidation and the most hard-hit provinces were the Punjab, United Provinces and Bombay. The total number of banks failing in the Punjab was 35 with a paid-up capital of 36.74 lakhs, in U. P. 18 with a paid-up capital of 27 82 lakhs, and 21 in Bombay with a paid up capital of 111.08 lakhs. No doubt most of these banks were small and weak and their elimination made for the strength of the banks in future, but it was very serious and unfortunate for a poor country like India, where banking facilities are too inadequate to meet the requirements of the people. It affected very adversely the bigger banks as well and thirteen of them with a paid-up capital of 135 84 lakhs had to go to the wall. This had a very adverse effect on the development of banks in future because it led many to suspect the soundness of the Indian banking system and the integrity and honesty of its management.

Causes of bank failures

1. *An abnormal disproportion between the cash resources and the deposit liabilities of the banks* :—We have seen above that the 18 big banks had a paid-up capital of Rs. 4 crores and total deposits of Rs. 22 crores. It was 18 to 19% in case of banks of the *A* class, and although this percentage of cash reserve compared favourably with those of other countries, yet on account of the peculiar circumstances of India it was inadequate. Mr. Keynes had already pointed out the danger lurking in this vulnerability of the Indian

Statement of Bank Failures in 1913-1918

Year	No. of Banks Failed	Capital in Rupees		
		Authorised	Subscribed	Paid up
1913 (for 2 months only)	12	2,74,00,000	1,64,56,000	35,13,000
1914	43	7,74,00,000	2,45,61,000	1,09,12,000
1915	11	56,50,000	7,91,000	4,60,000
1916	13	2,30,90,000	20,90,000	4,23,000
1917	9	76,50,000	35,76,000	25,26,000
1918	7	2,09,50,000	4,85,000	1,46,000
Total	95	16,21,40,000	4,79,59,000	1,79,80,000

banking system. Another striking thing was that while the authorised capital of the 95 banks that failed was 16 crores of rupees, their subscribed capital was only 4,79,59,000 rupees and the paid up capital was only 1, 79,80,000. The building up of huge deposits on the strength of meagre capital and reserve resources and the keeping of small cash reserves to meet the demand liabilities was bound to bring these banks to grief and ruin.

Percentage of cash to deposits

Banks	1913	1914	1915	1916	1917	1918
A class	18	21	22	21	25	23
B class	16	22	22	17	21	24

2. *Instability of the Indian Money Market* :— In 1912-13 the money market revealed signs of weakness. The Bank Rates of the Presidency Banks ranged between 7 and 8%, trade was brisk and yet the demand for Councils was weak. Hence, exchange began to weaken and the circulation of money did not expand in response to trade. The government were busy in pumping out money from the market instead of helping so that by March 1913 the total government balances had risen to 28 crores 95 lakhs of rupees. These tight money conditions affected the banks who were tempted to make large profits by lending at high rates. This made their liquid position rigid

banking. Want of experience and lack of knowledge concerning the rudimentary principles of banking and the consequent mismanagement of the banks' affairs was a very important cause of bank failures.

5. *Speculative dealings*:—A majority of the joint stock banks in India indulged in wide speculation in silver bullion and cotton, dealt in foreign exchanges and thus brought themselves to the brink of ruin. Most of them paid very high rates of interest (6 to 8 per cent) to attract deposits on account of keen competition between themselves and to be able to pay such high rates of interest as inducements to the depositors, minors and widows they resorted to illegitimate and unsound speculative dealings and these precipitated their ruin. An example of the multifarious and unauthorised activities of banks in those days is furnished by the following quotation of Sir Thomas Smith from Savkar's Joint Stock Banking in India: "An institution has no right to be called a bank which undertakes coach-building, ekka repairs, and medical attendance, the manufacture of soap and oil and certain things as machinery or engages in trade or manufactures of any sort even though it be stated as follows: the leasing, hiring and purchasing of all commodities and substances which can form the subject of purchase and sale."

6. *Fraudulent mismanagement by the directors*:—Many bank failures revealed gross negligence of duty and criminal breach of trust and embezzlements by the directors. There were no proper

and regular books of accounts maintained and they were not regularly audited by expert auditors. The directors and managers of several banks falsified the accounts of the banks in their charge. Fictitious accounts were opened in the name of a certain silver king specially in the Punjab and bogus entries were made to hoodwink the shareholders and the auditors and in this way a large amount of money was misappropriated by them. In matter of appointments nepotism was usually practised and some of the directors were also guilty of extravagance and acts of dishonesty. The auditors were not well trained and qualified, and if they were, they were not allowed to have a full and free access to all the relevant books of accounts. Window-dressing was often resorted to to conceal the true state of affairs from the general body of shareholders by presenting blooming balance sheets and drawing very rosy pictures of the banks, while in reality they were under knee deep water. In certain cases books of accounts were not complete and uptodate and this facilitated their manipulation by the dishonest and fraudulent directors and other members of the staff, by creating fictitious debtors and promissory notes. In several cases dividends were paid out of deposits and capitals and huge authorised capitals were mentioned in the prospectus to attract shareholders. In certain cases assets were deliberately taken away.

7. *Interlocking of directorates*: There was an undue combination and interdependence of banking and non-banking concerns under the same

directors and this produced very harmful results as in the Punjab. Concerns under the same management became debtors and creditors between themselves. The funds of the banks under these circumstances got locked up and they could not be taken back to tide over their difficulties. If one set of concerns under the same management failed or came to grief the other set was bound to suffer simultaneously. The mushroom growth of banks in the spur of the Swadeshi movement had not taken place out of real necessity felt for them but just to satisfy the fervour and temporary zeal of the people. This was also a weak spot in the banking system.

8. The indifference and *apathy of the general body of shareholders* was also responsible for the failure of banks. If they had taken a more intelligent and lively interest in the affairs of the banks, and not confined their interests only to the receipt of dividends, things would not have been so bad as they really were. Their constant vigilance would have exerted sufficient moral pressure to prevent the management from perpetrating frauds, criminal breaches of duty, and falsification of accounts etc.

9. *Apathy of the existing banks and lack of a Central Bank* : Upto 1934 our country had no central bank of issue co-ordinating the services of various banks and credit agencies and controlling both currency and credit to secure elasticity in the supply of money. There was no bankers' bank to act as a friend, guide and philosopher to the joint stock banks. There was no machinery to

pool together the scattered reserves into a central reservoir and mobilise it in averting a national crisis of the kind which befell our banking system in 1913-18. The various Indian joint stock banks did not co-operate between themselves and the attitude of the more powerful Presidency Banks and the Exchange banks was one of apathy and even positive hostility sometimes. The Government of India also sat quietly and did not move its little finger to pass emergency measures and give monetary help to the banks as other national governments do in their countries under similar circumstances. This attitude of the government and the foreign banks was most reprehensible and no language is too strong to condemn it. This attitude intensified the suffering of the depositors and investors.

10. *Lack of comprehensive and suitable banking legislation* : There is no special banking legislation in our country and prior to 1913 there was no regulation of banking except the provision made in the charters of the banks. In 1913 the Indian Companies Act contained a number of sections dealing with banks and banking business but these were inadequate. Then, unlike some countries notably, U.S.A., there was no statutory provision for minimum cash reserves which a bank must maintain, nor there were provisions for management and audit and the attitude of the government, as noted above, was one of apathy towards the Indian banks. Had there been a national government it would not have remained an idle spectator while the banks were dropping

out like ripe leaves from trees in autumn. This indifference of the government was also responsible for increased intensity and duration of the crisis.

These were some of the important and cogent reasons which brought about the banking crisis. The crisis had some good results *viz.* weaklings among the banks were eliminated, imperative necessity of special training and education in banking was emphasised, the imperious necessity of special and comprehensive banking legislation and of the establishment of a Central Bank at the earliest possible date were brought home to the Government and the people. On the other hand, it gave a setback to the growth of indigenous enterprise in joint stock banking and shook the confidence of the public in the banks. Owing to the mutual jealousies of Presidency Banks, the much desired central bank could not be established, and instead of it, the Imperial Bank of India came into existence in 1921.

The setback caused by these large numbers of bank failures was noticeable in the smaller number of banks started upto 1919. Thereafter there was again a boom in the development of banking companies in the post-war period and the resources of the joint stock banks were increasing unsteadily. Inspite of the post-war depression in trade, the number of banks, both *A* and *B* classes increased by 27 in six years (1919-25), but the crisis still continued and the period saw a failure of no less than 84 banks with a paid up capital of over 5 crores. The mortality of banks increased considerably from 1922, as a result of the depression

and, in the year following the Alliance Bank of Simla and the Tata Industrial Bank went into liquidation together with other 18 banks. Again, Punjab, U. P. and Bombay were the hardest hit and this time Bengal also was badly involved. The industrial banking and general economic development of these provinces was seriously retarded. The continuance of the crisis emphasised the need of a central bank, the maintenance of adequate cash reserves, and of a comprehensive banking law.

Statement of Bank Failures 1919-25

Year	Number of banks failed	Capital in Rupees		
		Authorised	Subscribed	Paid up
1919	4	52,50,000	6,47,185	4,02,737
1920	3	10,40,000	7,67,700	7,24,717
1921	7	70,40,000	5,80,965	1,25,329
1922	15	10,15,55,000	27,25,744	3,20,991
1923	20	21,80,89,995	9,92,30,480	4,65,47,325
1924	18	6,30,30,000	26,46,370	11,33,623
1925	17	1,89,80,000	25,41,695	18,75,795
	84	41,49,84,995	10,91,40,139	5,11,30,517

Owing to the disproportion between cash reserves and the deposits, the failures of banks continued even after 1926 and between that year and 1935, 215 banks went into liquidation with a paid-up capital of over Rs. 177 lakhs. The mortality became heavier during the recent world wide economic depression. Again the Punjab, U. P. and Bombay were the worst sufferers because of their commercial and industrial importance. The smallness of the capital involved and the large number of bank failures indicate that the recent depression has affected mostly the smaller banks. Two most recent failures of importance have been the Benares Bank and the Travancore National and Quilon Bank. The latter failed three years after the establishment of the Reserve Bank of India on 20th June 1938 after it had weathered the severest economic depression in the country. There *has been a widespread dissatisfaction in South* India with the management of the first banking difficulties of the country by the Reserve Bank during its short existence.

Percentage of cash to Deposits

	1926	1927	1928	1929	1930	1931	1932	1933	1934	1935
A Class Banks	15	13	13	14	12	12	13	15	15	23
B Class Banks	24	15	15	13	12	12	17	17	14	16

Statement of J. S. Bank Failures

1926-35

Year	Number of banks failed	Capital in Rupees		
		Authorised	Subscribed	Paid up
1926	14	70,80,000	7,05,815	3,98,145
1927	16	69,30,000	6,88,372	3,10,518
1928	13	81,70,000	31,65,740	23,11,717
1929	11	1,50,50,000	24,99,050	8,18,972
1930	12	6,27,40,000	46,55,445	40,59,644
1931	18	1,60,20,000	26,33,985	15,05,996
1932	24	4,90,20,000	11,79,005	8,09,172
1933	26	1,62,40,000	9,01,774	2,99,948
1934	30	2,42,00,000	14,30,995	6,22,553
1935	51	1,95,97,000	1,18,43,652	65,95,975
	215	22,50,47,000	2,97,03,833	1,77,32,640
1936-40				
1936	88	2,41,81,480	13,30,919	4,99,972
1937	65	93,93,371	18,11,815	11,51,656
1938	73	2,00,37,855	49,66,129	29,99,962
1939	86	1,81,40,000	19,15,658	10,05,937
1940	60	5,90,80,000	11,64,618	6,82,217
	372	13,08,32,706	1,11,89,139	63,39,744

The mortality among the joint stock banks during 1939 and 1940 was distributed as under:

	1939	1940
Madras	37	18
Bombay	10	3
Bengal	7	11
Punjab	4	6
Travancore	5	14
Cochin	14	4
Mysore	3	1
Sind	5	...
Orissa	1	...
Assam	...	1
Ajmer-Merwara ...	...	1
Hyderabad	...	1
Total	86	60

CHAPTER XX

THE CLEARING HOUSE SYSTEM

It has been pointed out before that the majority of payments in western countries in modern times is made through banks. Bank money, or cheques based on deposits, form the most important element in the media of exchange

and circulation. They are very safe and make it convenient, easy and cheap to remit money in large amounts. A cheque drawn to order and crossed specially is a very safe and convenient mode of making payments. Not only this, the cheques and bank notes effect a remarkable economy in the use of cash or metallic money. This economy in the use of money has been carried to its farthest limit and utmost perfection through the cheque system and the off-sets of cross payments by cheques. The institution which facilitates and effects this remarkable economy in the use of money is the Bankers' Clearing House, which together with the banks, forms the backbone of the credit economy.

A clearing house may be defined as an institution which simplifies and facilitates the daily settlement and exchange of debits and credits of banks in a certain locality. *Taussig* has defined it as "a general organisation of banks of a given place, having for its main purpose the off-setting of cross-obligations in the form of cheques." The principle of clearing and economy in the use of money through cheques can be easily illustrated by a simple example. Suppose, there are two businessmen—*A* and *B* and both of them are customers of the same bank. *A* buys certain goods from *B* and issues a cheque in favour of *B* on his bank. *B* sends this cheque for collection to his Bank and deposits the sum of the cheque to his accounts in the bank. As both of them are the customers of the same bank the payment and receipt of the amount through the cheque leads to

a simple transfer entry in the books of the bank, from *A's* A/c to *B's* A/c and not a single coin or note goes into circulation.

This is the clearing principle in its simplest form but it is carried further by the Clearing House. But this transaction does not stand by itself and the customers of the bank are not only two but many, all of whom through clearing principle can settle their mutual debts easily and economically. All these customers are constantly making deposits, and banks are constantly creating deposits through their loans to the customers; and the customers are constantly withdrawing funds by cheques. The cheques, being negotiable instruments, are passed from hand to hand through endorsement and delivery or by mere delivery in settlement of transactions, and before they are presented for payment across the counters of the banks many of them perform a number of transactions. In this way through their rapidity of circulation or velocity these continuous deposits effect a considerable economy in the use of the metallic money and notes.

If we suppose that all deposits in a country were received by one bank and all payments by cheques were made through it, then the use of cash could be done away with. The bank would simply make transfer entries in its books from the accounts of customers who drew the cheques to the accounts of those who were payees. Thus no money would pass and the accounts would be settled. The Clearing House System approximates to this description of a general bank on a small scale and

tries to achieve the same object: economy in the use of money though only in particular towns and not throughout the country.

Origin and Growth :—In the big cities therefore where there are a number of banks, this economy in the use of metallic money is carried still further through the organisation of the clearing house. Clearing house system has developed with the growth of deposit banking. It is very difficult to say as to who originated this system and when it came into existence. The London Clearing House was established in 1775 and that of New York in 1853. It was only when commercial banking had sufficiently developed that the necessity for a clearing house was felt, and necessity being the mother of invention, the clearing house system was gradually evolved and developed to its modern form. In the beginning the various banks after listing their claims used to send their clerks to other banks for the collection of cheques and settlement of mutual claims between themselves. These 'walk clerks' according to Matthews were the pioneers of the modern clearing house. They gradually evolved the plan of meeting at a certain place to avoid the loss of time, inconvenience and trouble of collection. There they presented the respective claims of their banks to one another after exchange of mutual salutations and struck the balances to be paid in cash by one bank to the other bank. In the beginning the authorities of the banks did not recognise this method, they rather resented such unauthorised meetings of the clerks. In course of time, however, when they realised the usefulness of

the system they gave it recognition and even rooms were hired for such clearings or cancellations of mutual obligations. Later on when the utility and significance of the economy effected by the system, its ease and simplicity and its facility in the settlement of debits and credits of respective banks was fully comprehended, the system with the development and expansion of deposit banking was regularised, proper rules and regulations were drawn up and the clearing house began to be managed more efficiently than before by the central or big banks and their branches in different cities having a number of bank offices belonging to different banks. The clearing banks began to keep balances with the Central Bank and their mutual obligations were settled through it by mere transfer entries in its books. There was no necessity of coins to be paid by one bank to the other to clear its debts. Later on non-clearing banks also, noticing the advantages of the system, opened accounts with clearing banks or the Central Bank, and thus the whole banking system was co-ordinated to facilitate the off-setting of inter-bank obligations in the forms of cheques. Thus, the modern clearing house system has grown through three broad stages: First, when the 'walk clerk' of every bank collected its claims against the other banks individually and the balances between the claims and counter claims were paid in cash after some time; second, when the clerks began to meet at a given place at a given time and settled their claims and counter claims there at one place instead of going to every bank individually as before, the balances, however, were still

payable in cash by one bank to another; third, when the clearing house is managed by the central bank where at the appointed time on every day the representatives of all the banks in a city congregate and through the Clearing House Accounts kept by the Central Bank on their behalf they cancel their mutual obligations by off-setting dabits and credits. The balances are no longer settled by paying cash nor are they settled between individual banks but between each bank and the Clearing House by simply passing transfer entries.

Illustration: Let us illustrate the working of the clearing principle at the present day. Suppose there are ten banks in a city *viz., A. B. C. D. E. F., G. H. I. and J.* The customers of Bank *A* have drawn cheques on it making it payable to the customers of the other banks and likewise they have received cheques in their favour from the customers of the other banks and they have sent them for collection to bank *A*. Similarly, the customers of other banks have claims in their favour on the respective banks and counter claims against them. In this way each bank receives cheques daily drawn on the other banks and sent to it for collection, and daily each bank has to pay the cheques drawn against it and deposited with the other banks for collection. These claims and counter claims can be easily off-set against one another and the difference alone is payable in cash; but the banks arrange not to pay the differences at all and keep a running account at the Central Bank office of the city wherein the balances are debited and credited and carried forward to

the next day, when they may be equalised and off-set. Or, the balances may be paid by cheques on the Clearing House Account of the debtor bank and credited to the Clearing House Account of the creditor bank without any money passing between them and the amount being transferred from the Clearing House Account of the debtor bank and credited to the Clearing House account of the creditor bank.

The various representatives of all these banks come daily with bundles of cheques sorted bankwise and arranged in chronological order and meet at the Clearing house. All the claims of the different banks against one another sent to the Clearing House are compared with one another. A balance is struck between the total sum of each bank's claims against other banks and total claims of all other banks against it. When the balance is against a bank, that amount is paid by it to the Clearing House, and if the balance is in favour of a bank, it receives that amount from the Clearing House as explained above. In this way by mere book entries the totals of the inter-bank claims and counter-claims are settled and off-set against one another and the greatest economy is secured in the use of money.

The member banks of the Clearing House are called ,"clearing banks" and the listing of the claims and counter-claims is done on specially printed forms which are called 'out books' and the compilers of these sheets are called 'out-clearers'. The clerks who carry the sorted bundles of cheques

to the Clearing House are called 'runners' who keep the cheques on the different clearing tables of the clearing banks. Then another set of clerks called "in-clearers" prepare "in books" in a manner similar to the preparation of the 'out books'. Then the two sets of books; 'out books' and, 'in books, are compared and their balances are entered in a General Balance Sheet of each bank on a printed from containing the names of the clearing banks, and Dr. and Cr. columns on either side of their names. From these Balance Sheets balances are struck and settled through the Clearing House Accounts maintained by the Central Bank.

The *London Clearing System* comprises three sets of clearing: Town, Country and Metropolitan. The first embraces banks within the City of London and there are two clearings in it: one in the morning and the other in the after noon. The second embraces all banks in England and Wales outside the Metropolitan district, and the third embraces the London Postal District outside the 'town clearing.' The timings of all these clearings are different.

Indian Clearing Houses: Before the establishment of the Reserve Bank of India, there were clearing houses at important centres like Bombay, Calcutta, Delhi, Madras and Rangoon. They were autonomous institutions and were supervised by the Imperial Bank of India on behalf of their members who used to settle their clearing balances through the a/cs. kept by them with the local office of the Imperial Bank. When the Reserve Bank came into existence and the scheduled banks opened

statutory a/cs. with it, the members of the clearing houses at the above centres were required to settle their clearing differences by cheques on their a/cs. with the Reserve Bank. Under sec. 58 (*p*) of the R.B. Act the Bank has been empowered to frame rules to regulate the clearing houses for the scheduled banks; but so far the Bank has not framed any regulations although it manages the clearing houses at Bombay, Delhi, Madras, Rangoon, Lahore, Karachi and Cawnpore on behalf of the clearing banks there. They are still autonomous institutions. In Calcutta the supervisor appointed by the General Committee of the Clearing Banks' Association conducts the clearing.

There are 20 Clearing Houses at present in India eight of which are managed by the Reserve Bank of India and its Agent, the Imperial Bank, at the offices and branches of the Reserve Bank at Bombay, Calcutta, Cawnpore, Delhi, Karachi, Lahore, Madras and Rangoon. The remaining 12 are managed by the Imperial Bank at Ahmedabad, Amritsar, Calicut, Coimbatore, Colombo, Lucknow, Madura, Mangalore, Nagpur, Simla, Allahabad, and Patna, and it has set up more houses at Rawalpindi and Peshawar. Where there is no clearing house the inter-bank balances are settled through cheques on the Imperial Bank. These two banks between them provide the necessary staff and supervision.

The member banks consist of all the Exchange Banks, the Imperial Bank, and the scheduled joint stock banks, all of which maintain accounts with the Reserve Bank or the Imperial Bank for

settling the Clearing House balances. A bank can become a member only with the consent of the $\frac{3}{4}$ of existing members and after a careful scrutiny of its B/S by an expert committee of the member banks. In some clearing houses, the would-be member of the organisation is required to have a minimum paid-up capital and reserves. All clearing houses have their own rules for admission of members, for the conduct of clearing as to hours, manner of settling debit and credit balances and dealing with dishonoured cheques etc. Every day at the fixed time the representatives of the member banks attend the clearing office at the Reserve Bank or the Imperial Bank and exchange their claims and counter-claims and strike balances which are settled through the Clearing House of the 'settling bank' by making book entries in the way explained above. Only cheques payable locally are cleared at these houses.

Advantages:—The Clearing House System simplifies and facilitates the daily settlement and exchange of debits and credits of the member banks as well as of non-member banks which want to take the facilities offered by the system. By off-setting the mutual obligations of banks *inter se* it effects economy in the use of cash or money to the utmost extent possible. It reduces appreciably the amount of the cash reserves to be maintained by every bank to meet its demand obligations and thus creates a further economy of cash. This economy of cash and the use of deposit currency tend to develop trade and commerce by relieving monetary deficiency or stringency to a great

extent. It increases manifold the benefit of credit economy by facilitating the cancellation of inter-bank obligations and plays an important part in the financial organisation of a country.

It stimulates the growth of the cheque habit in a country and the deposits of its banks; and by reducing the pressure on the cash resources of the banks and increasing their deposits, the Clearing House system enables the banks to give larger and cheaper credit to their customers.

The following figures of the Clearing House Returns at the eight offices and branches of the Reserve Bank of India show the total amounts of cheques cleared each year.

(*In Lakhs of Rupees*)

Period (*April to March*)	Total Amounts
1935-36	18,43,35
1936-37	19,31,66
1937-38	20,51,12
1938-39	20,03 20
1939-40	23,50.46
1940-41	21,91,24
1941-42	27,75,49*
1942-43	29,79,09
1943-44	45,79,22

**Excluding Rangoon from February 1942.*

To popularise the use of cheques in India more facilities should be given to private firms in up-country centres and registered private firms to clear their cheques. To obtain economies in the use of cash the cheque system should be more energetically developed. To popularise the use of cheques, they should be written like pass books and receipts in the local vernacular; withdrawals from post offices and payment of land revenue, taxes and rates should be done through cheques; rates of exchange on the up-country cheques should be lowered by the Imperial Bank and the co-operative banks and joint stock banks should permit the withdrawal of Savings Banks deposits by cheques.

CHAPTER XXI

Liability of a Paying and Collecting Banker

If a banker pays a cheque *in due course* he is entitled to debit the account of the customer with the amount of the cheque. If the banker pays a cheque bearing a forged signature of the drawer, or against the mandate of the drawer, he cannot debit the amount to the customer except in special circumstances. Even if a cheque bears a forged signature, or an un-authorised signature, the account of the customer can be debited, if the banker can show that the customer by his conduct or actions has misled him (banker) to pay a cheque which otherwise would have been dishonoured, *or*

on getting a notice of the forgery the customer keeps quiet and does not warn the banker, or the customer has induced the banker to think that the signature was genuine. *If by an act of omission or commission of the customer the banker suffers a loss re: forgery, then the customer is prevented from denying that the forged signature is his signature.* But if the banker does not suffer any direct injury or loss this rule will not apply. Similarly, if the customer ratifies an un-authorised signature of his agent, or does not object to the debiting of his account with cheques drawn by an un-authorised agent, his account can be debited with cheques bearing un-authorised signatures. And when a banker is unable to debit his customer's account with cheques bearing forged or un-authorised signatures of his customer, he can proceed against the last payee getting the amount from the bank to get a refund of the money, provided that such a last payee is not a holder in due course, *i.e.*, has obtained it through forgery or acted without good faith. If the person getting the payment is a holder in due course he can recover the amount only if he makes a demand for repayment within a reasonable time and before any detriment to the position of such a person. The same rule applies in case of return of cheques, bearing forged signatures, and presented through clearing to the collecting banker; if such cheques are returned after the stipulated time allowed by bankers, the loss will fall upon the paying banker, if the customer's account cannot be debited.

Unconfirmed material alterations which are

apparent also preclude a banker from debiting the customer with such cheques; *but, if the alterations of the amount are not apparent, the banker will not be liable "if the customer by his negligence in drawing the cheque had facilitated the alteration."* In the London Joint Stock Bank *vs.* Mac-Millan and Arthur. Lord Findlay said. "A cheque drawn by the customer is in point of law a mandate to the banker to pay the amount according to the tenor of the cheque. It is beyond dispute that the customer is bound to exercise reasonable care to prevent the banker being misled. If he draws the cheque in a manner which facilitates fraud, he is guilty of a breach of duty between himself and the banker, and he will be responsible to the banker for any loss sustained by the banker as a *natural and direct consequence of this breach of duty.................The customer is bound to take usual and proper precautions to prevent forgery*"

In India the Negotiable Instruments Act 1881 protects bankers in payment of materially altered cheques if the alterations are not apparent, and the cheques are paid according to their apparent tenors, in good faith and without negligence i.e. in due course.

Statutory Protection: Both the Negotiable Instruments Act 1881 in India and the Bills of Exchange Act 1881 in England provide for the protection of the paying banker in case of *forged indorsements* on cheques. It is thought, and thought rightly, that it is humanly impossible for a banker to know and recognise the signatures of

hundreds of men on all cheques passing through his hands, and therefore, if he exercises reasonable care in paying cheques with regard to indorsements, pays them in good faith and in the ordinary course of business, he is free from liability to the customer for forged indorsements on cheques. Inspite of this statutory protection the banker must exercise due diligence and care in examining all indorsements on *cheques payable to order* before making their payment.

With regard to *crossed cheques*, the banker is required to pay them through any bank or through a specified bank, a failure to do which will make him liable to the true owners thereof for losses sustained by them. Moreover, if a cheque is crossed to more than one bank, the banker should refuse to pay it, else he incurs a liability. But, if a banker pays a cheque bearing a non-apparent or obliterated crossing in good faith and without negligence to anybody other than a bank or a specified bank, the payment is valid against the claims of a true owner or even against the drawer. The same is true in case of un-authorised alterations or additions to crossing which are not apparent. To conclude then, *the paying banker is protected against forged indorsements on uncrossed order cheques, if he pays in good faith and in the ordinary course of business; and on crossed cheques, if he pays in good faith, without negligence, in the ordinary course of business according to the crossing.* According to the Indian Negotiable Instruments Act 1881, as amended in 1934, "where a cheque payable to order purports

to be endorsed by, or on behalf of, the payee, the drawee is discharged by payment in due course." And according to sec. 128, "Where the banker on whom a crossed cheque is drawn has paid the same in due course, the banker paying the cheque and (in case such cheque has come to the hands of the payee) the drawer thereof shall respectively be entitled to the same rights, and be placed in the same position in all respects, as they would respectively be entitled to and placed in, if the amount of the cheque had been paid to and received by the true owner thereof".

The obligation of a banker to pay cheques does not extend to domiciled bills i. e. bills accepted by a customer and made payable at his bank, provided that, if a banker has paid such bills for a long period, he cannot refuse to honour them without giving a reasonable notice to his customer.

A *collecting banker* is one who collects cheques, bills etc. on behalf of his customers or another banker. *He is an agent for his principal in this respect and therefore he incurs a personal liability if he does not observe the duties of a duly authorised agent.* He will be responsible to his customer for any loss or damage caused to the former on account of any omission or lack of care, skill and diligence in the discharge of his duties as a collecting agent. If he fails to present a cheque within reasonable time, or to present a bill at a specified place, he will have to compensate the customer for loss. *In collecting uncrossed bearer or order cheques for a customer the banker, is not protected by law. The collecting banker incurs*

the liability for converting the goods, which include bills, cheques and pro-notes, to the true owner, if open cheques bear forged indorsements, or the title of the customer is defective ; unless he can satisfy the court that he has acted in good faith and without negligence, and that the cheque was a crossed cheque. In open cheques, therefore, the collecting banker occupies the position of a mere holder for value, and his title is as good or bad as that of the customer for whom he collects. In case of a forged indorsement, however, the collecting banker can recover the amount from the indorsers who indorsed the open cheque after the forgery was committed. According to Sir *John Paget*, "apart from the question of forged indorsement, if the customer has either no title to the cheque or his title is defective, the banker is a holder in due course with good independent title against all the prior parties on the cheque." But, while collecting cheques for his customers, the banker is only acting as an agent, has no better title than that of his principals, and therefore, he cannot claim the privileges of a holder for value.

In crossed cheques, however, the collecting banker gets a statutory protection and is not held liable for conversion provided he acts in good faith and without negligence. According to Sec.131 of the Indian Nego'i b'e Instruments Act 1881 "A banker who has in good faith and without negligence received payment for a customer of a cheque crossed generally or specially to himself shall not in case the title to the cheque proves defective, incur any liability to the true owner of the

cheque by reason only of having received such payment." "A banker receives payment of a crossed cheque for a customer within the meaning of this section notwithstanding that he credits his customer's account with the amount of the cheque before receiving payment thereof. *To get this statutory protection, the cheque must be crossed and must not bear a forged signature of the drawer; the banker must act only as an agent and not as a principal; he must collect the cheques only for his customers; and finally, he must receive the payment in good faith and without negligence.* Failure to open accounts with satisfactory references, or to verify endorsements etc., constitute acts of negligence. *This statutory protection, however, does not extend to bills of exchange in collecting which the bankers must exercise due care and diligence to avoid liability.*

CHAPTER XXII

Present War and Indian Banking

When the present total war started on 3rd September 1939, the Indian Banking System was a congeries of uncoordinated, small, independent units. Except the few scheduled banks and co-operative apex banks, and a few smaller banks and indigenous bankers on the approved list of the Reserve Bank of India, all others were outside its purview, *control and regulation. It was not an*

organic system and lacked coherence. The Imperial Bank enjoyed a monopolistic and privileged position and the Exchange Banks were entirely independent of the Reserve Bank. The war has affected our banking system in a number of ways and has brought some important changes in banking resources, the structure of bank balance sheets, and the methods of employment of funds. There has been a mushroom growth in the number of banks and their branches, and to control this indiscriminate flotation of banks and opening of branches, not in new areas, but multiplying them in the localities where branches of banks already exist, the Government has to intervene by passing Capital Issues Control Order to regulate the capital structure of new banks and to limit the scope of managing agencies in banking. "The considerable development that has taken place in recent years in banking, especially the rapid growth of banking resources and of the number of banks and branches" has led to the introduction of a Draft Bill in the Legislature by the Government in November 1944 to provide for a separate banking legislation to assist and regulate the growth of banking on healthy lines, to protect the depositors and increase the capacity and efficiency of the banks to foster the trade and commerce of the country. These objects are very laudable indeed but care should be taken to see that no obnoxious and cumbrous restrictions are imposed and very high standards laid down, which may check the growth and expansion of banking and credit in a backward country like ours.

The immediate effect of the war 'was panic

among the depositors and consequent withdrawals of deposits from the banks. The non-scheduled banks were more adversely affected in this respect than the scheduled banks. This tendency has varied with the changing fortunes of the war. On the 8th of September 1939, the consolidated return of the scheduled banks showed a decline of Rs. 5·12 crores in their deposits and of Rs. 6.98 crores in their balances with the Reserve Bank. The call rate in Bombay therefore jumped upto $1\frac{1}{4}\%$ and the 3 months' deposit rate to $2\frac{1}{2}\%$. But the panic was short lived and after re-adjustment to the new situation the public confidence revived and the call rate slipped back to $\frac{1}{2}\%$. Then on the fall of France and the out-break of war with Japan there was panic again and heavy withdrawals, but this also proved a temporary phase. Thereafter there has been a continuous and steady increase in the deposits with the return of confidence.

The most striking feature of banking during this war has been the phenomenal expansion in the volume of deposits due to the abnormal increase in the note issue. The total deposits of the scheduled banks in Aug. 1939 stood at Rs. 249.45 crores; on 24th December 1943 they rose to Rs. 655,07 crores i.e. a rise of 250% and by July '44 they stood at Rs. 759,29 crores i.e. a rise of over 300%. By the end of 1944 they stood at Rs. 800 crores. In the three years prior to the war the deposits of these banks increased only by Rs. 20 crores. The expansion has been most pronounced in case of demand deposits, which shows

a welcome increase in the liquidity preference of the public. The demand deposits which stood at, Rs. 134 crores on 1st September 1939 rose to Rs. 500·8 crores on 31st December 1943, while the time liabilities in the same period increased from Rs. 102 crores to Rs. 157 crores. The proportion of demand liabilities to total liabilities improved from 56 to 76%, while that of the time deposits fell from 44 to 24%. By July 1944 the time deposits rose to Rs. 186 crores i.e. an increase of 80%, while the demand deposits rose by Rs. 445 crores to Rs. 578 crores i.e. an increase of about 430%. In 1943-44 while the net increase in demand liabilities was nearly the same as in previous years the net increase in the time deposits was nearly double. A difference of Rs. 151 crores in the demand deposits occurred within 26th June 1942 and 25th June 1943. This shows the close relation between expansion of note issue and the enormous expansion in the volume of deposits, which is "merely the counterpart of monetary inflation." This tendency is feasible in other countries also. Expansion of bank credit has been determined during the war by inflation and the presence or absence of cheque habit. Upto March 1941 the expansion of deposits was very little but thereafter with the mounting spiral of currency inflation the demand deposits rose very sharply. Between September 1939 and August 11, 1944 bank deposits rose by Rs. 528 crores while the note issue increased by Rs. 727 crores. The rate of increase during the last fifteen months of the period under review had been about Rs. 16 crores per month. The

increase in deposits has not been commensurate with the increase in note circulation.

Does this enormous expansion in the volume of demand deposits, showing liquidity preference of the public warrant an increased state of liquidity in the structure of the assets of the banks? There is an improvement in the liquidity position of the banks which is borne out by the remarkable changes in the structure of the assets and liabilities of the banks. Broadly speaking the volume of cash viz. cash in hand and with the Reserve Bank has shown a rising trend excepting temporary falls in the busy season. The balances of the scheduled banks with the Reserve Bank increased from Rs. 25 crores on 1st September 1939 to Rs. 89 crores on 31st Dec. 1943 i.e. an improvement of $3\frac{1}{2}$ times. It is the easy money conditions caused by heavy inflation which explains the large cash balances with the Reserve Bank. Very few banks have approached the Reserve Bank for financial accommodation. The cash holdings of the scheduled banks increased from Rs. 7·08 crores in 1939-40 to Rs. 20·57 crores in 1943-44, while their balances with the Reserve Bank increased from Rs. 17·43 crores to Rs. 63·63 crores.

For the first nine months of 1943-44, there was an appreciable rise in cash holdings and balances, but, with a gradual decline thereafter, the proportion of these to the total liabilities was less than at any time since June 1940. The anti-inflationary drive of the Government seems to have affected them appreciably. Together they stood at Rs. 24·51 crores at the eve of the war and by

1944 they stood at Rs. 112 crores, registering an increase of 300%. The proportion of cash to deposits, which stood at 10% at the eve of the war, rose to its peak of 16.73% in 1942-43 and then dropped to 14·05% in 1943-44. But it is the proportion and not the volume which has tended to decline. The increase in cash has been more than proportional to the increase in liabilities even in the last two years of rapid growth of deposits, and on a/c of inflation and high liquidity in the money market, the banks have met all needs for cash and been able to maintain highly fluid position. Barring the seasonal variations and the first nine months of the war, the proportion of cash to deposits has always been more than 12%. If the monthly returns are taken into consideration, the peak was reached in November 1940 at 21·16% and the ebb in April 1943 at 12·17%. The annual average of 16·66% in 1940-41, of 14·51% in 1941-42, of 16·73% in 1942-43 and of 14·05% in 1943-44 compares favourably with the prewar average for three years of 12·16%. Even the lowest percentage during the war in April 1943 is higher than this prewar average.

The most noticeable feature of the war time changes in the structure of bank balance sheets is the steady and substantial rise in the volume of advances and bills discounted, maintained even during the slack season for trade demands for the year 1943-44. The seasonal variations, changes in business and trade, war time panicky developments and controls have been powerful factors in determining their volume and proportion to the

total deposits. There has been a pronounced trend towards decline in the importance of advances since the war upto 1942-43 From Rs. 125·89 crores in 1939-40 the advances fell to Rs. 122·13 crores in 1940-41; to Rs. 120·20 crores in 1941-42 and to Rs. 95·68 crores in 1942-43. In 1943-44 there was a sharp increase to Rs. 156·14 crores. Similarly the volume of bills discounted fell from Rs. 5·25 crores in 1939-40 to Rs. 3·84 crores in 1940-41, rose to Rs. 4·93 crores in 1941-42, dropped again to Rs. 2·18 crores in 1942-43 and rose to Rs. 5·59 crores again in 1943-44. In the first six months of the war the boom in commodity trade and prices led to an increase in advances and bills discounted from Rs. 109·3 crores or 43·80% of the total deposits in August 1939 to Rs. 163·1 crores or 62·91% in March 1940. Then from April 1940 there was a continuous decline and thereafter since January to March 1941 there was an increase when the figures stood at Rs. 117·22 crores or 36·39% of the deposits. From June 1941 to October 1942 there was again a decline and from September to March 1942 they averaged Rs. 81·76 crores or 19·3% of the deposits. Thereafter there has been a substantial and steady increase upto March 1944. In April 1944 they stood at Rs. 230·87 crores or 33·07% of the deposits. Thus there was an increase of 275% in 16 months or more than twice the prewar figure of Rs 112 crores. Between May and July 1944 there was again a slightly downward trend perhaps because of seasonal factors. The decrease in advances and loans is traceable to relatively smaller degree of reliance

on bank finance which is at present placed by trade and industry generally. However, it should be borne in mind that excepting the period from May 1942 to January 1943 the volume of advances and bills discounted has never fallen below the pre-war figure of Rs. 112 crores which is in sharp contrast to the British banks which have been suffering grave contraction of advances even from the prewar period. But this absolute expansion in the volume of advances and bills has been accompanied with a relative decline in their proportional importance in the banks' balance sheets. The percentage of advances and bills to the deposits fell from 53·38% in 1939-40 to 46·86% in 1940-41, to 39·23 in 1941-42, to 23·83% in 1942-43 and rose slightly to 26·98 in 1943-44. It can not be expected that they would rise to more than 50% of the deposits in future. The ban on speculative loans on the security of bullion and produce does not seem to have contracted the volume of advances.

Another notable feature has been a substantial increase in investments mainly Government short and long term bonds or gilt-edged securities. The bulk of the overseas and domestic trade is now being handled by the Government themselves, and consequently, the role which banks used to play in the matter of financing the traders has been shifted to the back-ground. The problem before Indian banks today is not one of netting in deposits but of finding remunerative outlets consistent with safety for employment of their funds. In the absence of suitable avenues the banks have to put

in their funds in Government securities the interest from which forms an important source of income The normal channels of employment are closed and cash credits have declined in their demand. The loss of overseas markets in Europe and Japan etc., exchange control and restrictions on exports and imports, price control and transport difficulties have curtailed the movement of produce and the holding of stocks requiring financial accommodations from banks. Moreover, individuals and firms enjoy a high degree of liquidity and finance themselves. The Government also advance materials to war contractors. The delay in assessing E P.T. left firms with surplus funds and reduced the demand for loans. The flotation of war loans and bonds and defence certificates etc., compulsory saving drive schemes of the Provincial Governments, and restrictions on commercial investments, have also resulted in increased investments in Government or gilt-edged securities. The scheduled banks are now keeping about 60% of their assets in Government securities and the Imperial Bank has an even higher percentage. Therefore the banks are interested in keeping low rates of interest and cheap money conditions, because a rise in the interest rates will entail heavy losses through capital depreciation. The loss in advances has been taken by investments.

The capital and reserves of the banks have not increased as fast as their deposits and investments and their proportion to total liabilities has declined. The proportion of capital resources to deposits in the case of Imperial Bank has declined from

12·8% to 5·3% between 1939 and 1943, of the scheduled banks from 10·8% to 5% and of the big five from 9 3% to 5·4%. Since 1943 with the coming into force of legislation regarding capital and reserves, and the Capital Issues Control Order, there has been an increase in the capital resources of the banks, but, as compared by the proportion of the increase in deposits, it is negligible.

By far the most outstanding feature of the war has been the flotation of a large number of new banks with large capital resources and the opening of a number of branches by the old as well as the new banks especially in areas not previously served by the joint stock banks. Many smaller banks, hitherto not included in the second schedule of the Reserve Bank, have also strengthened their capital structure. Therefore the number of scheduled banks increased from 55 in December 1939 to 76 in June 1944. Further 879 new branches have been opened, and although many of them are serving in places already provided with banking facilities, nearly 136 towns have been served by branches of banks for the first time. The number of offices of the scheduled banks which stood at 1328 in June 1939 rose to 2143 by June 1944 and to 2207 by September 1944. Out of this the Imperial Bank had 413 by September 1944, about 1/3 of the total number increased belong to the big five and 2/3 to the rest. These figures do not include the branches and offices of the smaller non scheduled banks which have shown a special tendency to expand, and, taking them into account, the growth in numbers has been very rapid during the

war. Such mushroom growth of banking must be cautioned against in organisation and management; in view of the post war difficulties and disturbances to the economy of the country. In a country where banking habit is still undeveloped and the public is so uneducated and non-vigilant, restrictions and checks on mushroom growth of banking are imperatively necessary. Therefore the Government in May 1943 promulgated the Capital Issues Control Order under the D. I. R., prohibiting the flotation of new companies, issue and public offering of shares, stocks, bonds, and debentures except with the sanction of the Central Government, amended the Section 277 of the *Indian Companies Act* to require the banks to comply with law, to control the capital structure of banks and limit the scope of managing agencies. They have also introduced a bill for banking legislation in November 1944 which is in circulation for eliciting public opinion. War time banking has been stringently controlled in all the countries of the world, and the need of control and regulation is greater in our country, where the Government has neglected banking for such a long time. The war has provided a splendid opportunity for it, and it is hoped that before long there would be an independent Bank Act. Among the big five the Punjab National Bank increased its offices from 66 in December 1939 to 139, the Central Bank from 114 to 230 by June 1944 but, it is the new Bharat Bank started in 1942, which has registered most phenomenal increase in its offices from 6 in 1942 to 186 by March 1944.

APPENDIX

Sections 277 F to 277 N of the Indian Companies Act, 1936, Relating to Banking Companies

277 F. *Definition of a banking company*: A banking company means a company which carries on as its principal business* the accepting of deposits of money on current accounts or otherwise, subject to withdrawal by cheque, draft or order, notwithstanding that it engages in addition in any one or more of the following forms of business, namely (1) the borrowing, raising or taking up of money, the lending or advancing of money either upon or without security; the drawing, making, accepting, discounting, buying, selling, collecting and dealing in bills of exchange, hoondis, promissory notes, coupons, drafts, bills of lading, railway receipts, debentures, certificates,

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* *A difficulty having arisen as to smaller companies whether within the terms of this definition they are banking companies or not, the Government of India, on the recommendation of the Reserve Bank, introduced a bill on 14th Sep '42 to amend the section so as to oblige such non-scheduled banks to maintain a minimum cash reserve To achieve this end the bill provides that any company which uses as part of its name the word 'bank' 'banking' or 'banker' shall be deemed to be a banking company irrespective of whether the business of accepting deposits of money on current account or otherwise subject to withdrawal by cheque, draft or order is its principal business or not. The bill came into force from 1st Nov. 1943.*

scrips and other instruments, and securities whether transferable or negotiable or not, the granting and issuing of letters of credit, travellers' cheques and circular notes; the buying, selling and dealing in bullion or foreign exchange including foreign bank notes; the acquiring, holding issuing on commission, under-writing and dealing in stock, funds, shares, debentures, debenture stock, bonds, obligations, securities and investments of all kinds; the purchasing and selling of bonds, scrips or other forms of securities on behalf of constituents or others; the negotiating of loans and advances; the receiving of all kinds of bonds, scrips or valuables on deposit, or for safe custody or otherwise; the collecting and transmitting of money and securities; (2) acting as agents for Governments or local authorities or for any other person or persons, the carrying on of agency business of any description other than the business of a managing agent, including the power to act as attorneys and to give discharges and receipts; (3) contracting for public and private loans and negotiating and issuing the same; (4) the promoting, effecting, insuring, guaranteeing, underwriting, participating in managing and carrying out of any issue, public or private, of State, Municipal or other loans or of shares, stock, debentures, or debenture stock of any company, corporation or association and lending of money for the purpose of any such issue; (5) carrying on and transacting every kind of guarantee and indemnity business; (6) promoting or financing or assisting in promoting or financing any business undertaking or industry, either existing or new, and developing or forming the same either through the instrumentality of syndicates or otherwise; (7) acquisition by purchase, lease, exchange, hire or otherwise of any property immovable or movable and any rights or privileges which the company may think necessary or convenient

to acquire or the acquisition of which in the opinion of the company is likely to facilitate the realisation of any securities held by the company or to prevent or diminish any apprehended loss or liability; (8) managing, selling and realising all property movable and immovable which may come into the possession of the company in satisfaction or part satisfaction of any of its claims; (9) acquiring and holding and generally dealing with any property and any right, title or interest in any property movable or immovable which may form part of the security for any loans or advance or which may be connected with any such security; (10) undertaking and executing trusts; (11) undertaking the administration of estates as executor, trustee or otherwise; (12) taking or otherwise acquiring and holding shares in any other company having objects similar to those of the company; (13) establishing and supporting or aiding in the establishment and support of associations, institutions, funds, trusts, and conveniences calculated to benefit employees or ex-employees of the company or other dependents or connections of such persons; granting pensions and allowances and making payments towards insurance; subscribing to or guaranteeing moneys for charitable or benevolent objects or for any exhibition or for any public, general or useful object; (14) the acquisition, construction, maintenance and alteration on any building or works necessary or convenient for the purposes of the company; (15) selling, improving, managing, developing, exchanging, leasing, mortgaging, disposing of or turning into account or otherwise dealing with all or any part of the property and rights of the company; (16) acquiring and undertaking the whole or any part of the business of any person or company, when such business is of a nature enumerated or described in this section; (17) doing all such other things as are incidental or conducive to the promotion or advancement of the business of the company.

277 G. *Limitation of activities of banking company*: (1) No company formed after the commencement of the Indian Companies (Amendment) Act, 1936, for the purpose of carrying on business as a banking company or which uses a part of the name under which it proposes to carry on business the word 'bank' 'banker' or 'banking' shall be registered under this Act, unless the memorandum limits the object of the company to the carrying on of the business of accepting deposits of money on current account or otherwise subject to withdrawal by cheque, draft or otherwise along with some or all of the forms of business specified in section 277 F. (2) No banking company whether incorporated in or outside British India shall after the expiry of two years from the commencement of the said Act carry on any form of business other than those specified in section 277 F: provided that the Governor-General-in-Council may, by notification in the Gazette of India, specify in addition to the business set forth in clauses (1) to (17) of section 277 F other forms of business which it may be lawful under this section for a banking company to engage in.

277 H. *Banking company not to employ managing agent*: No banking company shall after the expiry of two years from the commencement of the Indian Companies (Amendment) Act, 1936, employ or be managed by a managing agent other than a banking company for the management of the company.

277 I. *Restriction of commencement of business by banking company*: Notwithstanding any thing contained in section 103 no banking company incorporated under this Act after the commencement of the Indian Companies (Amendment) Act, 1936, shall commence business, unless shares have been allotted to an amount sufficient to yield a sum of at least fifty thousand rupees as working capital and unless a declaration duly verified by an affidavit signed by the

directors and the manager that such a sum has been received by way of paid-up capital has been filed with the registrar.

277 J. *Prohibition of charge on unpaid capital:* No banking company shall create any charge upon any unpaid capital of the company, and any such charge shall be invalid.

277 K. *Reserve Fund.* (1) Every banking company shall, after the commencement of the Indian Companies (Amendment) Act, 1936, maintain a reserve fund. (2) Every banking company shall, out of the declared profits of each year, and before any dividend is declared, transfer a sum equivalent to not less than twenty per cent of such profits to the reserve fund until the amount of the said fund is equal to the paid-up capital (3) A banking company shall invest the amount standing to the credit of its reserve fund in Government securities or in securities mentioned or referred to in section 20 of the Indian Trusts Act, 1882, or keep deposited in a special account to be opened by the company for the purpose in a scheduled bank as defined in clause (e) of section (2) of the Reserve Bank of India Act, 1934 : provided that the provision of the sub-section shall not apply to a banking company incorporated before the commencement of the Indian Companies (Amendment) Act, 1936, till after the expiry of two years from the commencement of the said Act.

277 L. *Cash Reserve*: (1) Every banking company shall maintain by way of cash reserve in cash a sum equivalent to at least one and a half per cent of the time liabilities and five per cent of the demand liabilities of such company and shall file with the Registrar before the tenth day of every month a statement of the amount so held on the Friday of each week of the preceding month with

particulars of the time and demand liabilities of each such day. (2) For the purposes of subsection. (1) 'demand liabilities' means liabilities which must be met on demand, and time liabilities which are not demand liabilities. (3) Nothing in this section or in section 277 K. shall apply to a scheduled bank as defined in clause (e) of section 2 of the Reserve Bank of India Act, 1934 (4) If default is made in complying with the requirements of section 277 G., section 277 H., section 277 J., section 277 K. or section 277 M. or with the requirements of the section as to the maintenance of a cash reserve, every director or other officer of the company who is knowingly and wilfully a party to the default shall be liable to a fine not exceeding five hundred rupees for every day during which the default continues, and if default is made in complying with the requirements of this section as to the filing of the statement referred to in sub-section (1), to a fine not exceeding one hundred rupees for every day during which the default continues

277 M. *Restriction on nature of subsidiary companies:* A banking company shall not form or hold shares in any subsidiary company except a subsidiary company of its own formed for the purpose of undertaking and executing trusts, undertaking the administration of estates as executor, trustee or otherwise and such purposes set forth in section 277 F. as are incidental to the business or accepting deposits of money on current account or otherwise.

277 N. *Power of court to stay proceedings:* (1) The Court may on the application of a banking company which is temporarily unable to meet its obligations make an order staying the commencement or continuance of all sections and proceedings against the company for a fixed period of time on such terms and conditions as it shall think fit and proper and may from time to time extend

the period. (2) No such application shall be maintainable unless accompanied by a report of the Registrar: provided however, the Court may, for sufficient reasons, grant interim relief, even if the application is not accompanied by such report. (3) The Registrar shall for the purposes of his report be entitled at the cost of the company to investigate the financial conditions of the company and for such purpose to have the books and the documents of the company examined by an accountant holding a certificate issued under section 144.

Proposals for an Indian Bank Act by the Reserve Bank of India, 1939

For many years Indian public opinion has been insistent on the framing of a comprehensive banking legislation to regulate and assist the development of banking on healthy lines and to prevent heavy bank mortality caused by mismanagement, inexperience and speculative tendencies of the bank managers The C.B.I Committee in 1929 had recommended that after five years of its coming into existence the Reserve Bank of India should formulate a scheme for Banking Legislation and Regulation. In pursuance of this recommendation and to remove considerable difficulties of interpretation of the definition of Banking in case of very small institutions, to differentiate between the larger and the smaller banks, to amplify the penal causes of the Indian Companies Act 1936, and to provide for more deterrent penalties in the interests of the depositors and for it to impose certain minimum restrictions on capital structure of banks and their investments, and to compel them to maintain a reasonable liquid position, provide adequate reserves and expedite liquidation proceedings, the Bank submitted its proposals in the form of a Draft Bill in Nov. 1939 for circulation and eliciting of public opinion together with an explanatory memorandum.

Co-operative banks are exempted from the operations of the proposed Act which is to apply to the whole of British India including Baluchistan and the Santhal Parganas. Part I of the bill defines banking and banking companies to remove the difficulties of interpretation caused by Sec 277 F of the I Co. Act. It defines banking as "the accepting of deposits on current a/c or otherwise subject to withdrawal by cheque." Part II defines the extent of business of a banking company which means a company with 'bank' or 'banker' as part of its name and which does the banking business. Sec. 277 I. prescribes and regulates the paid up capital of banks incorporated after 15th January 1937 only, and leaves free all those established prior to that date and carrying on business with paid up capitals of less than, Rs 50,000. Moreover, the minimum limit of Rs. 50,000 is too low and the position worsens when a bank with so low capital starts a branch in a large city only to attract deposit at higher interests. To remove such weaklings and to minimise the chances of bank failures, the Bill provides a minimum paid up capital of Rs. 1 lakh before a banking company can commence business; for Bombay and Calcutta the minimum should be Rs 5 lakhs, and for places with a population of 1 lakh and over the minimum should be Rs 2 lakhs; provided that no bank with a paid up capital and reserve of less than Rs. 20 lakhs will be allowed to operate beyond the province or state in which it has its principal place of business. All these will be subject to an overriding minimum of Rs. 20 lakhs. Further, to prevent the tendency among the banks to float a company with very large authorized captital and then to commence business without adequate capital being subscribed and paid up, the Bill provides that 50 p. c of the authorized capital should be subscribed, and 50 p. c. of the subscribed capital should be paid up before the commencement of business by a bank. The C.B.I. Committee

also made a similar recommendation and this is the proportion of the existing larger Indian joint stock banks. The bill provided a time limit of 2 years for existing companies and suggested its enforcement for new companies by Jan. 1, 1940.

The draft proposal with regard to the minimum share capital differentiates between smaller and larger places and prevents banks with meagre capital from opening branches to tap deposits at distant places, where the public may be ignorant of their real position.

Reserve Fund and Cash Reserve.—Secs. 277 J, 277 K and 277 L may remain as they are, but the proviso to K should be dropped and the penal clause in 277L may be transferred to a general penal clause and made wider in scope. The operation of K and L should be confined to non-scheduled banks. The general reserve fund should be unencumbered

Minimum of liquid assets:—30 p. c. of the demand and time liabilities of the banks should be held in liquid assets—cash or trustee securities excluding immovable property and 50 p c. of such securities should be such as mature within 10 years. This minimum should not be used as a security for advances even by the Reserve Bank of India except in emergencies when the operation of the Act may be suspended for the time being for a limited period. 75 p. c of the British Indian liabilities should be kept by them in the form of assets in British India—Indian sterling securities, British Government securities maturing within 10 years and export sterling bills and export bills drawn in India and expressed in non-sterling currency.

277 M should remain in tact. Penalties for infractions of all the preceding sections together with the power to Reserve Bank to put a banking Co. into liquidation, if it fails to bring its reserves upto the prescribed

quota within a reasonable time, are provided.

Elaborate provisions for liquidation in which the Cos. Act is most defective are also proposed. No further proposals for indigenous bankers are made.*

Proposed Banking Legislation For India

Although the Bank submitted its Draft Bill in November 1939 to the Government, yet the Government took five years to prepare the final draft and introduce the bill in the Legislature. The Draft Bill is based on the original proposals of the Reserve Bank. The new Bank Bill of the Government gazetted on Nov. 18,1944 aims at consolidating and amending the law relating to Banking Companies. It defines banking as the "accepting of deposits repayable on demand" and the banking company as a company which may be wound up under the Indian Companies Act 1913 and which carries on the business of banking in British India. It leaves out of its ambit the indigenous bankers and money lenders on the ground of impracticability and complexity of the credit structure and the regulation of money lending by provincial governments. It treats equally banks registered in United Kingdom or in British India and treats others as foreign banks which cannot be allowed to carry on the business of banking in British India without a licence. All the licensed banks will have to keep a deposit with the Reserve Bank equivalent to the amount of their paid up capital and reserve in cash or in approved securities or partly in one and partly in the other. The bill thus discriminates invidiously between British and Indian States banks or banks of neighbouring countries. The restriction of the bill to British India alone to the exclusion of Indian States is a

**For a detailed study refer to the "Proposals for An Indian Bank Act" by Reserve Bank of India 1939.*

retrograde provision which strikes at the very root of an all-India comprehensive banking system. The failure of the Quillon and Travancore Bank seems to have had no effect on the framers of the bill. This clause of the bill is therefore "politically obnoxious and economically vicious." The bill further prohibits a bank from engaging in trade or undertaking trade risks directly or indirectly and from engaging managing agents participating in the profits of the company or on a salary disproportionate to the resources of the bank. This clause seeks to avoid the heavy bank mortality due to inefficient management and secures independent bank management.

To eradicate the evils of the present day banking system, viz. over-concentration of banks in a few cities and towns and their weak capital structure, the bill restricts the rights of the banks to commence business after the expiry of two years from the commencement of this Act, unless their paid up capital and reserves are one lakh of rupees in any case, of Rs. 5 lakhs in Bombay or Calcutta, of rupees two lakhs in other towns of over a lakh of population, of rupees 10,000 in places of less than one lakh population and of rupees 20 lakhs in case of banks doing business in more than one province or having its Head Office in an Indian State. Such a provision it is feared may lead to over-capitalisation and amalgamation with all their concomitant evils. Moreover the bill definitely discourages the smaller banks which cater to the needs of the small investors and fails to provide for an even distribution of banking facilities over the different parts of the country. Such small banks have been of great use to the small traders and they can with advantage be permitted to render services to a group of small villages. It puts the smaller banks in a straight jacket. The proposed link between capital structure and population is rather arbitrary and cumbrous. The banks in the Indian States have been unnecessarily

discriminated against. In a country, where banking and credit facilities are so inadequate to its needs, such arbitrary, highly un-reasonable and harsh provisions will check the development of the banking habit.

Another serious defect in the existing banking organisation is the wide disparity between the subscribed capital and authorised capital and the paid-up capital and subscribed capital. To remove this the bill provides that the subscribed capital should not be less than half the authorized capital, and the paid up capital should not be less than half the subscribed capital. To strengthen the financial position of the bank, the bill further provides that every non-scheduled bank, out of its annual declared profits, before the declaration of any dividend, shall transfer 20% of the profits to the reserve fund, until the reserve equals the paid up capital It will maintain cash reserves equivalent to 1½% of its time liabilities and 5 p c of its demand liabilities Besides strengthening the financial position of the banks and increasing the stakes of the shareholders therein these provisions would protect the depositors But their real security lies in efficient management An additional safeguard provides that every banking company shall maintain in cash, gold or unencumbered approved securities valued at current market prices, an amount equal to 25 p. c. of the total of its liabilities in British India This will hurt many smaller banks working with time deposits, because this provision does not draw any distinction between demand and time deposits Dr. L. C Jain has suggested that balances of the non scheduled banks kept with the scheduled banks should be regarded cash as in the nature of scheduled banks, balances with the Reserve Bank of India. Moreover these provisions only aim at regulating the outward appearance and do not provide a complete safeguard to the depositors. If the 75 p. c. of the remaining assets of the banks are invested in risky and

speculative undertakings the insistence on a 25 p c. liquidity of the total deposits is a poor safeguard to the depositors The problem of liquidity of assets should be linked with the investments rather than with deposits

Finally, the bill aims at restricting unsecured advances to bank directors and their concerns under them, because there has been a failure of many a bank in the past on account of indiscriminate advances to the directors and their concerns. The bill provides, therefore, that no banking company shall make any loan or advance on the security of its own shares or grant unsecured loans or advances to its directors or to firms or companies in which it or any of its directors is interested as partner, director, or managing agent It has been argued by critics that it would check the development of commerce and industry by discriminating against common directorate which is a special feature of the modern industrial development in India An absolute and unqualified restriction on common directorate would deprive banks of the services of prominent and experienced industrial magnates as their directors and therefore the bill seeks to regulate only unsecured advances*.

In fact the Bill is unsatisfactory and defective in many respects and shall not conduce to the development of harmonious relations between the Reserve Bank and other credit agencies It fails to provide for a regular control of banks to assist the development of banking on healthy lines as was envisaged by the C.B I Committee. The inclusion of banks of non-Indian origin imports politics into the bill The flotation of a large number of banks with big capitals due to inflation since the present war and prior to the Capital Issues Control Order seems to have powerfully influenced the framers of the draft bill, which follows closely the original draft bill of the

*Dr. L. C. Jain Hindustan Times "26-2-45."

Reserve Bank, except the provision for monthly returns for inspection and licensing of banks incorporated outside British India or U.K. The C. B. I. Committee had also recommended granting of licences freely to existing banks by the Reserve Bank and to foreign banks and that the opening of a branch by an existing bank should be subject to the approval of the Reserve Bank. This was to discourage the multiplication of branches in big cities already provided with banking and credit facilities and to encourage their expansion in new areas.

The regulation of branch banking and the prevention of over-trading by smaller banks can be better achieved by the institution of the system of licences as envisaged by the C. B. I. Committee and renewing them annually. It would not only secure the development of healthy banking practice but would also avoid wasteful competition and safeguard the interest of the depositors which seems to have actuated the framers of the bill in fixing such high capital limits with reference to area and population without due regards to the volume of business transacted by the various institutions. The percentage of the liquid assets to the total deposits has been reduced from 30 in the original draft to 25 in the Draft Bill. This provision will also harm the smaller banks and affect adversely the financing of small traders and agriculturists. In view of the inadequate rediscounting facilities, undeveloped bill habit and absence of warehousing facilities, this statutory liability might be resisted by the banks. It is better to fix a statutory maximum and minimum percentage of liquidity in proportion to deposits and leave it to the Reserve Bank to insist upon its maintenance. Inspection and audit should be regularised and done by independent auditors. The Bill fails to bring within its ambit the Imperial Bank and the Exchange Banks; the former is to continue to enjoy a monopolistic and privileged position to the chagrin

of the other banks. It is the smaller banks which will be strangled and weeded out by the powerful and bigger banks. The Bill therefore should be suitably amended to encourage the development of harmonious relations between the central bank and others and growth of an organic system of sound and healthy banking comprising both British and Indian India The Reserve Bank should help the smaller banks to grow bigger by permitting them to increase their capital and continue to play their important role in the agricultural economy of the country. Because of its highly controversial nature and far-reaching suggestions the bill has been referred to a Select Committee by the Indian Legislative Assembly.

5. What do you understand by Elasticity of currency? What provision has been made in the Reserve Bank of India Act with a view to introduce an element of Elasticity in the Indian Currency system? How can emergency currency be issued by the Reserve Bank? 10

6. Discuss some of the causes which have militated against the development of Joint Stock Banking in this country. What suggestions would you make to make Banking more popular? 10

7. Give a short description of the different kinds of Hundies which are generally in use, indicating their special features. Draw a specimen Hundi by way of illustration. 10

8. Explain clearly how the Exchange Banks finance the foreign trade of India. What criticism has been made with regard to their methods of business?

1938

Only five questions are to be attempted

1. Explain Discounting of Bills. 10

What precautions should a banker take in discounting Bills of Exchange?

2. In what different forms can a businessman get credit from a bank? 10

Explain these forms, pointing out the difference between them.

3. Examine the following endorsements, and state whether they are in order, giving reasons for your answer :— 10

(a) A cheque payable to the Trustees of the estate of Mr. Ramswarup Varma.
Endorsed : For self and co-trustees Sheo Shankar Lal,

(b) A cheque payable to Shrimati Sushila Devi, Endorsed : Shrimati Sushila Devi.

2. Describe briefly the constitution, functions, and advantages of a co-operative credit society. How does it secure its loanable funds? How is it helped in this matter by the central co-operative agencies?

3. Explain clearly the discounting and rediscounting operations of banks. Why is the discounting of bills so popular with banks? 10

4. Discuss the causes of a banking crisis. In what way and to what extent can the Reserve Bank be of help in a banking crisis in India? 10

5. Discuss the liabilities of (*a*) a paying banker, and (*b*) a collecting banker, in respect of a crossed cheque. 10

6. Show the relation between a bank's loans and its deposits. How far is a deposit created against a loan similar to issue of notes? 10

7. Explain briefly the nature of the business of the Exchange Banks in India. Point out the criticisms that have been levelled against them, and suggest the lines of reform. 10

8. Define a cheque, and bring out clearly the significance of the term 'negotiable instrument. Show the various devices by which a holder of a cheque can be protected in spite of the cheque being a negotiable instrument. 10

9. Write short notes on *any five* of the following:— 10

(i) Endorsement in blank.
(ii) Cash credit
(iii) Scheduled Bank.
(iv) Treasury Bill.
(v) Holder in due course.
(vi) Postal order.
(vii) Liquid assets.

8. *A* draws a cheque in favour of *B* or order. *B* endorses it in blank and sends his clerk *D* to pay into his account at his Bank. *D* writes above *B's* endorsement 'Pay *D* or order' and himself endorses it to *C* who pays *D* the face value of the cheque endorses it, and sends it to his Bank where it is collected and credited to his account. *D* absconds with the money. Has the collecting bank incurred any liability, and, if so, to whom, in the following circumstances?—

(*a*) The cheque is open.

(*b*) It is crossed generally.

(*c*) It is crossed 'Not Negotiable'.

9. How do you account for the recent banking failures in India? Point out the main recommendations of the Central Banking Enquiry Committee for the regulation and control of Banking in India as regards organization, management, and audit.

1940

Only **five** *questions are to be attempted. All questions carry equal marks.*

1. What precautions should the banker take in opening accounts with—

(*a*) married women;

(*b*) clubs;

(*c*) joint-stock companies?

2. (*a*) *A* wishes to keep a sum of Rs. 5,000 on fixed deposit with the Indian Bank, Ltd., for a period of six months. The bank accepts the deposit.

Give a specimen of the Fixed Deposit Receipt which will be given to *A* by the bank. What would be the usual terms and conditions of the deposit.

(*b*) How does a Floating Deposits Account differ from Savings Bank Account in regard to—

(i) withdrawal;

(ii) overdrafts and cash credits?

3. How far is the banker protected under the Indian Negotiable Instruments Act if, after taking every possible precaution,—

(*a*) he pays a cheque bearing a forged endorsement of X who is a customer of his;

(*b*) he pays a cheque bearing a forged endosement of X who has no account with him;

(*c*) he pays a cheque in which the amount has been fraudulently increased?

4. In what circumstances does a collecting banker become a holder in due course?

Discuss the respective rights of a collecting banker and those of a holder in due course.

5. Indicate and briefly explain the various kinds of credit usually allowed by Indian banks to—

(*a*) persons engaged in distributive trade;

(*b*) importers of foreign goods.

6. How far has the new Indian Insurance Act strengthened the position of the banker with regard to Life Insurance Policy as a collateral against advances?

7. Discuss the significance of the following documents which are used in connection with banker's advance against stock-exchange securities:—

(*a*) Demand Promissory Note.

(*b*) Blank Transfer Deed.

(*c*) Letter of Continuity.

8. (*a*) Bearer bonds, with coupons attached, are deposited by a customer with his banker with instructions to cut off the coupons periodically and collect them when due and place the amount to the customer's credit.

(*b*) Similar bonds are deposited with the banker but the customer himself cuts off the coupons nnd leaves them with the banker with instructions to collect them and place the amount to his credit.

Advise whether the banker will have a general lien on the coupons and bonds in respect of a general balance of account in either of the above cases. Give reasons for your answer.

Write short explanatory notes on ***any four*** of the following:—

(*a*) Delivery orders.

(*b*) *Cash orders.*

(*c*) Travellers' cheqnes.

(*d*) Letters of Indication.

(*e*) Acceptance credit.

(*f*) Cheque crossed 'Not Negotiable'.

1942

Only **five** *questions are to be attempted. All questions carry equal marks.*

1. What precautions should a banker take in opening accounts with—

(*a*) married women ;

(*b*) partnerships ;

(*c*) joint-stock companies ?

2. What is meant by *marking* a cheque ? In what circumstances is it marked, and what does the drawee banker write when it marks a cheque ?

3. Write notes on :—

Acceptance for honour ; Case of need ; Protesting a B/E; and Discounting a B/E.

4. Explain the procedure step by step that a person should take in opening a current account with a bank.

5. In what ways does a banker invest its funds? Write an explanatory note on each item on the assets side of a bank Balance Sheet.

6. Explain the meaning of the clearing house system. Describe its mechanism.

7. What is meant by crossing a cheque? Discuss the difference between general and special crossing.

8. Explain the following terms clearly —

Traveller's letter of credit; circular notes; confirmed banker's credit; and documentary bill.

9. Give standard forms of—

an inland B/E; a specially crossed cheque; and a promissory note.

1943

Only **five** *questions are to be attempted. All questions carry equal marks*

1. Discuss the relationship between a banker and his customer.

2. Write brief explanatory notes on :—

Revolving Credit, Circular Letter of Credit, Acceptor for Honour, and Forged Cheque.

3. Explain the term 'Cash Reserve'. What factors should guide a banker in regulating his cash reserve?

4. Explain the following classes of endorsements on a cheque, giving examples :—

(*a*) Endorsement in full.
(*b*) Sans recourse endorsement.
(*c*) Restrictive endorsement.
(*d*) Blank endorsement.

5. Explain the meaning and object of crossing a cheque. Distinguish between general and special crossing, giving examples.

6. Critically examine the merits and demerits of stock exchange securities as collateral for bank advances to customers.

7. Discuss the causes responsible for the absence of a bill market in India.

8. What is meant by 'Negotiable Instrument'? Are the following negotiable instruments? Give reasons for your answer.

(a) A cheque.
(b) A Hundi.
(c) A share warrant.
(d) A bill of lading.

9. What is meant by Clearing House organization? Describe its mechanism in India.

1944

Attempt only **five** *questions. All questions carry equal marks.*

1. How do you account for the popularity of discounting of bills of exchange by commercial banks? What precautions should a banker take in discounting bills? Why is their use restricted in India?

2. Explain the term 'Lien' as one of the ways of securing their advances by bankers. Under what circumstances can the banker exercise this right?

3. Describe the various functions and services of a modern joint-stock or commercial bank in India.

4. Write short notes on :—

Till money; Treasury Bills? London Acceptance Credit; Cash Credit and *Hundis*.

5. Discuss the liability of a 'paying banker' with regard to the payment of cheques, and explain the 'statutory protection' which he gets under the Indian Negotiable Instrument Act.

6. State, explain, and illustrate 'material alterations' on a cheque. Under what circumstances is the holder of a cheque not liable for any material alterations?

7. Discuss the merits and demerits of life assurance policies as collaterals for a banker's advances to his customers.

8. What are the various ways in which a bank's deposits arise? How do loans create deposits? Explain.

9. Discuss the liabilities of the various parties to a bill of exchange. A draws a bill on B who accepts it. After acceptance A endorses it to C, C to D, D to E, and E to F, and F endorses it back to D. Has D any right against E if the bill is not met at maturity?

10. Critically examine the various proposals of the Reserve Bank of India for the regulation and control of banking in India, pointing out the improvements upon the existing banking law.

1945

Attempt **any five** *questions. All questions carry equal marks.*

1. Compare Price Stability and Exchange Stability as aims and objectives of the Indian monetary policy, both as regards desirability and feasibility. 10

2. Examine the nature and merits of the monetary policy of the Government of India during the period of depression, 1931-1936. 10

3. What measures have been taken by the U. P. Government for financing medium and small-scale industries? How far have they been found to be satisfactory? Suggest improvements in the existing agency. 10

4. 'The exchange banks in India form an unabsorbable and uncontrollable part of the Indian banking system.' Discuss. 10

5. (*a*) Would you advocate a Mixed or Federal type of Co-operative Central Bank for the U.P.? 10

(*b*) Should interlending among Central Banks be permitted?

6. Examine the case for the nationalization of the Reserve Bank of India. 10

7. In what respects does the Reserve Bank of India resemble the Federal Reserve system of the United States? What are the points of difference? What changes would you suggest in its constitution and working to increase the scope and value of its activities? 10

8. Examine the merits of the application of the principle of the separation of Banking and Issue departments in the case of (*a*) Bank of England, and (*b*) the Reserve Bank of India.

9. Are you convinced that an organized money market does not exist in India? If so, discuss the conditions under which it can come into existence. 10